96-104

PRODUCT LIABILITY RISK RETENTION ACT OF 1979

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 1789

AND

STAFF WORKING DRAFT

TO FACILITATE THE ABILITY OF PRODUCT SELLERS TO ESTABLISH PRODUCT LIABILITY RISK RETENTION GROUPS, TO PURCHASE PRODUCT LIABILITY INSURANCE ON A GROUP BASIS, AND FOR OTHER PURPOSES

AND

H.R. 6152

TO FACILITATE THE ABILITY OF PRODUCT SELLERS TO ESTABLISH PRODUCT LIABILITY RISK RETENTION GROUPS, TO FACILITATE THE ABILITY OF SUCH SELLERS TO PURCHASE PRODUCT LIABILITY INSURANCE ON A GROUP BASIS, AND FOR OTHER PURPOSES

APRIL 22 AND JULY 30, 1980

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PRODUCT LIABILITY RISK RETENTION ACT OF 1979

TUESDAY, APRIL 22, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, D.C.

The committee met at 10:10 a.m. in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The hearing will come to order. Today we are holding hearings on S. 1789, the Risk Retention Act, one of the administration's proposals for addressing the product liability problems faced by businesses, particularly small businesses. The Risk Retention Act is intended to provide businesses with an alternative means of obtaining product liability insurance coverage. It does this by permitting product sellers to form self-insured co-ops called risk retention groups, which may cover all or part of their member product liability risk.

We are pleased to have a number of witnesses this morning representing a broad cross section of business: consumer, legal, and insurance industry views.

I hope the testimony this morning will be helpful in outlining some of the product liability problems faced by business and whether and how the Risk Retention Act might be able to meet those problems.

[The bills follow:]

II

96th CONGRESS
1st Session

S. 1789

To facilitate the ability of product sellers to establish product liability risk retention groups, to purchase product liability insurance on a group basis, and for other purposes.

IN THE SENATE OF THE UNITED STATES

September 21 (legislative day, June 21), 1979

Mr. Culver (for himself, Mr. Nelson, and Mr. Pressler) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

---

A BILL

To facilitate the ability of product sellers to establish product liability risk retention groups, to purchase product liability insurance on a group basis, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Product Liability Risk Retention Act of 1979".

STATEMENT OF POLICY AND DECLARATION OF PURPOSE

Sec. 2. The policy of Congress which shall be implemented through this Act is to facilitate the formation and sound operation of product liability risk retention groups by product sellers by eliminating government regulation, which may be necessary for commercial insurers which insure a large number of policyholders, but which is inappropriate and costly for these special purpose groups formed to meet limited risk exposures. The purposes of this Act are to—

(1) reduce insurance costs for some product sellers;

(2) insure the prompt payment of legally valid claims made by persons injured by products;

(3) promote competition among providers of product liability and completed operations risk coverage; and

(4) reduce the outflow of capital and premiums to offshore jurisdictions which have been attracting captive insurance companies of United States parent corporations.

DEFINITIONS

SEC. 3. As used in this Act the term—

(1) "affiliate" means any person, directly or indirectly, controlling or controlled by such other person, or any person under direct or indirect common control with such other person;

(2) "control" means ownership or control, directly or indirectly, of more than 50 per centum of the total

combined voting power of all classes of stock entitled to vote and where appropriate, actual control where exercised other than through ownership of stock;

(3) "approved risk retention group" means a risk retention group which, pursuant to this Act, has been issued a certificate of approval by the Secretary which has not been revoked;

(4) "claimant" means a person asserting a legal cause of action or claim and, if the cause of action or claim is asserted on behalf of an estate, claimant includes claimant's decedent;

(5) "completed operations" means operations performed by a person, or those performed for such person by an independent contractor, which operations have been completed or abandoned prior to the occurrence giving rise to the claim, at premises which are not owned or controlled by such person;

(6) "group participant" means a member of a risk retention group or a member affiliate whose risk exposure has been assumed by a risk retention group;

(7) "insurance" includes insurance, excess insurance, reinsurance, and surplus lines insurance;

(8) "member" means a person who, directly or indirectly, has an interest in a risk retention group as

the result of having made a contribution to the capital of such group;

(9) "member affiliate" means any person who is an affiliate of a member of a risk retention group;

(10) "net direct fees" means the net amounts received by an approved risk retention group as consideration for assuming and retaining the risks of its group participants other than—

(A) nonrecurring items, such as contributions to its capital;

(B) amounts returned to its members (other than in payment for covered losses) such as risk agreement dividends, refunds, and returns for risk agreement cancellations; and

(C) that portion of the group's gross compensation allocable to risks ceded to excess insurers or reinsurers;

(11) "person" means an individual, corporation, partnership, association, joint venture, business trust, unincorporated organization, or any other similar entity, except that, and when used in reference to a risk retention group, such term means a corporation or other limited liability association taxable as a corporation;

(12) "product liability risk" includes liability for damages on account of physical injury or emotional harm to individuals or on account of damage to or loss of use of property arising out of the manufacture, importation, distribution, lease, or sale of a product other than liability arising before the manufacturer, importer, distributor, lessor, or seller has relinquished possession of the product;

(13) "risk agreement" means the contract between a risk retention group and one or more of its group participants whereby the risk retention group agrees to assume all, or any portion, of the product liability and completed operations risk exposure of such person or persons;

(14) "risk retention group" means a person organized for the primary purpose, and whose principal activity consists, of assuming and spreading all, or any portion, of the product liability and completed operations risk exposure of two or more persons;

(15) "Secretary" means the Secretary of the Department of Commerce;

(16) "State" means any State of the United States and the District of Columbia; and

(17) "title II group" means any group comprised of persons engaged in the same or similar business

which has as one of its purposes the purchase of product liability or completed operations insurance on a group basis.

TITLE I—RISK RETENTION GROUPS

APPROVAL

SEC. 101. (a) The Secretary shall promulgate rules and regulations which set forth the requirements for approval of risk retention groups.

(b) Rules and regulations promulgated pursuant to subsection (a) shall provide that the Secretary in determining whether to approve a risk retention group may consider—

(1) the amount and liquidity of the assets of the applicant relative to the risks to be assumed and retained by the applicant;

(2) whether the reserves established or to be established by the applicant comply with the requirements of section 103;

(3) the adequacy of the expertise, experience, and character of the person or persons who will manage the applicant;

(4) the adequacy of the loss prevention programs of the applicant and its group participants;

(5) the adequacy of the insurance coverage obtained by the applicant in order to comply with section 102 of this Act;

(6) the overall soundness of applicant's plan of operation;

(7) whether, in its application, the applicant has failed to disclose material facts or circumstances bearing upon its qualifications for approval by the Secretary; and

(8) such other factors deemed relevant by the Secretary to balancing the goals of promoting the formation and efficient operation of risk retention groups and trying to assure that such groups are able to meet their risk agreement obligations.

(c) The assets of the applicant may include irrevocable letters of credit on behalf of the applicant, in the form prescribed by the Secretary by regulation and issued by a national bank or a State bank approved for that purpose by the Secretary.

(d) Any risk retention group whose principal place of business is located in a State may apply for a certificate of approval. Each application shall be in such form and contain such information as the Secretary, by regulation, may prescribe. Each application shall include the applicant's plan of operation and an agreement by the applicant and by its group participants—

(1) to permit and to pay the reasonable cost of any audits and examinations which the Secretary may

determine necessary prior to approval, if granted, and those conducted pursuant to section 109;

(2) to furnish any additional information relevant to the purposes of this Act, which is in the possession or subject to the control of the applicant and its group participants, as the Secretary may require; and

(3) to pay the fees provided for in section 110.

(e) The Secretary may make such audits or examinations of an applicant and its group participants which are necessary to ascertain whether an applicant meets the requirements for approval established pursuant to this Act.

(f)(1) Except as otherwise provided in paragraph (2), the Secretary shall not issue a certificate of approval to any risk retention group in which the risk coverage afforded to any one person exceeds 5 per centum of the total risks assumed by the risk retention group.

(2) The Secretary may issue a certificate of approval to any risk retention group that meets all the requirements for approval set forth in this Act if the Secretary determines that such approval is necessary to carry out the purposes of this Act and that, notwithstanding noncompliance with the 5 per centum limitation described in paragraph (1), the group, as approved, is likely to be financially sound and capable of functioning to shift and distribute the risks of its participants.

(g) For the purpose of applying the maximum per centum limitation on an individual person's risk coverage set forth in section 101(f)(1), the risk exposure of persons who are affiliates shall be aggregated and considered attributable to only one affiliate.

(h) The Secretary may approve any risk retention group which meets the requirements established pursuant to this Act. The Secretary may make a group's approval subject to such terms and conditions as the Secretary may determine necessary or appropriate, including restrictions upon the admission of new members to an approved group, the withdrawal of members from an approved group, and the distribution of the assets of an approved group to its members. The Secretary is authorized to issue a certificate of approval to any approved risk retention group.

(i) Any refusal to issue a certificate of approval hereunder shall be made by a written order issued by the Secretary, which order shall specify the factual conclusions and legal authority upon which the refusal is based.

LIMITATIONS ON RISKS AND MEMBERSHIP

SEC. 102. (a) The Secretary may require, as a condition to approval of a risk retention group, that a risk retention group agree to limit the maximum amount of risk it accepts and retains with respect to any one loss or in the aggregate, or with respect to one or more of its group participants, and to acquire and keep in force insurance coverage for losses in excess of such maximum limitations. In satisfying the requirement of the preceding sentence the group shall obtain only policies which provide explicitly that—

(1) their proceeds shall enure to benefit of claimants of the approved risk retention group and shall be payable to a receiver or other officer of a court in the event of the group's inability to satisfy its risk agreement obligations; and

(2) the insurer shall give the risk retention group and the Secretary a minimum of forty-five days' notice in writing prior to the policy's cancellation or substantial modification.

(b) The risk retention group shall provide the Secretary with a copy of the policy or policies for the required coverage, together with the certification of the insurer, and all documents which substantially modify that coverage.

(c) An approved risk retention group shall not assume, directly or indirectly, the product liability and completed operations risk exposure of persons other than its members and member affiliates.

(d) Notwithstanding subsection (b), an approved risk retention group may assume the product liability and completed operations risk exposure of its members and member affiliates, which exposure arises from the operation of hold harmless, indemnity, or other similar agreements executed by a group participant and either—

(1) a supplier of products or services to the group participant;

(2) a purchaser of the products or services from the group participant; or

(3) a person who holds the products of the group participant on consignment for sale.

(e) No person shall become a member of an approved risk retention group unless all or a portion of its product liability or completed operations risk exposure, or that of one or more of its affiliates, is to be assumed by that group pursuant to a risk agreement. No person shall continue to be a member of an approved risk retention group for more than sixty days after that group has ceased to assume all or a portion of its product liability or completed operations risk exposure, or that of one of its affiliates, pursuant to a risk agreement.

(f) The Secretary shall prescribe rules and regulations which provide for the return of the capital contribution of any person required to withdraw from an approved risk retention group pursuant to subsection (e). Such rules and regulations shall provide that—

(1) the withdrawing member's capital contribution shall be increased or decreased, as appropriate, to reflect the claims experience (including incurred but not

reported losses), earnings, losses, and distributions of the group, all determined through the application of generally accepted accounting principles, during the period the withdrawing person was a group member; and

(2) the member's adjusted capital contribution shall be returned, together with interest at the rate provided for in the risk agreement, or if no rate was provided for, at the prevailing prime rate in the United States accruing from the date of withdrawal, in installments over such a period of time as is necessary in order to determine the appropriate adjustments under paragraph (1), and to avoid jeopardizing the group's financial condition, but, in any case, no longer than five years after the date of withdrawal.

(g) No approved risk retention group shall, directly or indirectly, acquire reinsurance from any of its members or member affiliates.

(h) An approved risk retention group shall not make non-pro-rata assessments or retroactive adjustments, based on an individual participant's loss experience, to the fees paid by that group participant for coverage.

RESERVES

SEC. 103. (a) The Secretary shall require an approved risk retention group to establish and maintain reasonable and adequate reserves to meet incurred losses, including incurred but not reported losses, and loss adjustment expenses arising from the risks it retains. The Secretary shall not require (or permit) such reserves to exceed levels determined through computations using accepted actuarial methods and based on reasonable actuarial assumptions.

(b) In addition to the reserves required by subsection (a), the Secretary shall require an approved risk retention group to establish and maintain a reasonable and adequate reserve for unearned fees paid or to be paid to the group by its group participants. For purposes of accounting for the financial results of the group, such reserve shall not be less than 50 per centum of the annual net direct fees paid or to be paid to the group by its group participants. Each approved risk retention group shall include this reserve, as well as the reserves required by subsection (a), as a liability in all its financial statements.

(c) Each approved risk retention group shall act as a fiduciary with respect to its reserves which it shall hold for the benefit of potential claimants against its group participants. The reserves of an approved risk retention group shall be invested in the same manner and with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

(d) No approved risk retention group shall, directly or indirectly, acquire any securities of, make or guarantee any loans to, receive loans from, or otherwise acquire any interest in, any of its members or member affiliates.

ANNUAL AND OTHER REPORTS

SEC. 104. (a) Each approved risk retention group shall submit to the Secretary an annual report and such other reports which the Secretary determines to be necessary or appropriate in order to carry out the purposes of this Act.

(b) The reports required to be submitted pursuant to this section shall be in such form and contain such information and certifications as the Secretary, by regulation, may prescribe. The annual report shall include a statement of financial condition and operations substantially similar to the annual statement approved by the National Association of Insurance Commissioners.

APPLICABILITY OF STATE LAW

SEC. 105. (a) This Act and the rules and regulations issued hereunder shall preempt any and all State laws which would—

(1) make unlawful the formation or operation of approved risk retention groups;

(2) regulate, directly or indirectly, the formation or operation of approved risk retention groups with respect to: the assumption, spreading, or ceding of all, or any portion, of the product liability or completed operations risk exposure of their group participants; any related functions; or any other functions permitted by the Secretary;

(3) make it unlawful for any person to provide or sell product liability and completed operations insurance, insurance-related services, or management services to an approved risk retention group; or

(4) regulate, directly or indirectly, the provision or sale of product liability and completed operations insurance, insurance-related services, or management services by any person to an approved risk retention group.

(b) Nothing contained in this Act shall be construed to bar a State from collecting, on a nondiscriminatory basis, from an approved risk retention group applicable premium and other taxes which are levied on admitted insurers and surplus lines insurers under State law.

ANTITRUST LAWS

SEC. 106. (a) The Federal antitrust laws shall be applicable to approved risk retention groups, their group participants, and to any person engaged therein, notwithstanding the provisions of section 2(b) of the McCarran-Ferguson Act.

(b) Nothing contained in this Act shall be construed to create any immunity or defense to any civil or criminal action under any Federal antitrust law.

(c) For the purposes of this section, the term "Federal antitrust laws" shall mean the laws included within the definition of the term "antitrust laws" in section 1 of the Clayton Act (15 U.S.C. 12), and the Federal Trade Commission Act (15 U.S.C. 41).

SECURITIES LAWS

SEC. 107. (a) The ownership interests of members in approved risk retention groups shall not be considered securities for purposes of the Securities Act of 1933 (15 U.S.C. 77a), and for purposes of the Securities Exchange Act of 1934 (15 U.S.C. 78a).

(b) Approved risk retention groups shall not be considered to be investment companies for purposes of the Investment Company Act of 1940 (15 U.S.C. 80a–1).

PRODUCT LIABILITY DATA

SEC. 108. (a) Notwithstanding section 552 of title 5, United States Code, neither the Secretary, nor any other officer or employee of the Department of Commerce or bureau or agency thereof, may—

(1) use the information furnished under the provisions of this Act for any purpose other than the admin-

istrative and statistical purposes for which it is supplied;

(2) make any publication whereby any person furnishing data pursuant to this Act can be identified; or

(3) permit anyone other than the sworn officers and employees of the Department or bureau or agency thereof to examine the individual applications and reports.

No department, bureau, agency, officer, or employee of the Government, except the Secretary in carrying out the purposes of this Act, shall require, for any reason, copies of applications or reports which have been retained by any person. Copies of applications or reports which have been retained shall be immune from legal process, and shall not, without the consent of the person concerned, be admitted as evidence or used for any purpose in any action, suit, or other judicial or administrative proceeding.

(b) The Secretary may require each approved risk retention group to collect and provide to the Secretary such data regarding its product liability claims experience as the Secretary may deem to be appropriate. Notwithstanding subsection (a), the Secretary may disclose the data collected pursuant to this subsection in a format which does not identify, directly or indirectly, the individual persons whose risk has been assumed by the approved risk retention group, together with their individual product liability claims experience.

AUDIT AND MANAGEMENT

SEC. 109. (a) Each approved risk retention group, its members, and its member affiliates shall be subject to audit or examination of their books and records by the Secretary as may be necessary in order to gather information relevant to any of the purposes of this Act. Such audits and examinations may be conducted at reasonable intervals without advance notice.

(b) The Secretary may require that each approved risk retention group engage an independent qualified public accountant to conduct such examination of any financial statements of the group, and of other books and records of the group, as the accountant may determine necessary to enable the accountant to form an opinion as to whether the financial statement and schedules of the group are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with the group's preceding year. Such examinations shall be conducted in accordance with generally accepted auditing standards and shall involve such tests of the books and records of the group as are considered necessary by the independent qualified public accountant. In carrying out the Secretary's responsibilities under this Act, the Secretary may rely upon financial statements prepared in the manner described in the preceding sentence, either in response to the Secretary's request or, if prepared within a reasonable time prior to such request, upon financial statements prepared for some other purpose.

(c) With the consent of the head of the agency, the Secretary may utilize personnel of other agencies of the Federal Government in administering this Act. The Secretary may also utilize independent contractors to perform ministerial functions under this Act, such as conducting audits and examinations.

FEES

SEC. 110. (a) Each applicant for approval under section 101 shall pay to the Secretary a nonrefundable application fee of which shall cover the cost of processing an application for a certificate of approval. The fee required by this subsection shall be in addition to the amounts provided in subsection 101(d)(1).

(b) The Secretary shall establish and collect from each approved risk retention group a nonrefundable annual fee calculated as a percentage of its net direct fees charged to its group participants.

(c) The annual fee shall include an amount sufficient to reimburse the Secretary for the direct costs of supervising the approved risk retention group.

REVOCATION OF APPROVAL

SEC. 111. (a) The Secretary may revoke the certificate of approval of an approved risk retention group—

(1) upon the request of the group;

(2) upon the refusal of the group to permit an audit or examination of its books and records pursuant to section 109;

(3) upon the approved risk retention group's violation of this Act, or any regulations promulgated thereunder, or the terms and conditions of the Secretary's approval of the risk retention group;

(4) upon the Secretary's determination that the group is primarily engaged in the business of investing, reinvesting, or trading in securities;

(5) upon the Secretary's determination that the primary purpose or principal activity of the group has ceased to be the assumption and spreading of the product liability and completed operations risk exposure of the participants of the group; or

(6) for any reason which, had it existed or had it been known to have existed, at the time the Secretary considered the group's application for a certificate of approval, would have justified the Secretary to refuse to issue its certificate of approval initially.

(b) The Secretary shall, prior to revocation, give any approved risk retention group thirty days' written notice of the Secretary's intention to revoke the group's certificate of approval. The Secretary shall provide the group an opportunity during that period to correct the deficiencies in its operation which are stated in the notice to be the grounds for revocation. Prior to revocation of its certificate of approval, any approved risk retention group or group participant may request in writing, and shall be granted an opportunity for, an informal hearing to contest such revocation.

(c) The Secretary shall revoke a certificate of approval by written order. Such order shall be served upon the risk retention group and shall set forth the factual conclusions and legal authority upon which the revocation is based.

HEARINGS AND JUDICIAL REVIEW

SEC. 112. (a) Any hearing provided for in section 111 shall be held in the District of Columbia. Such hearings shall be informal and need not be conducted in accordance with the provisions of section 554 of title 5, United States Code. The Secretary shall promulgate rules and regulations which specify who may participate in these informal hearings.

(b) Any order issued by the Secretary pursuant to this Act shall be final except that an approved risk retention group, an applicant for a certificate of approval, or a group participant of such group or applicant, may appeal any order by filing in the United States District Court for the District of Columbia, within sixty days after the date of service of such order, a written petition requesting that the order of the Secretary be modified, terminated, or set aside. Such order shall be reviewed in accordance with the provisions of section 706 of title 5, United States Code.

PROCEEDS OF REINSURANCE

SEC. 113. In the event that an approved risk retention group is determined to be insolvent by a court of competent jurisdiction because it is unable financially to pay its debts when due, proceeds from reinsurance policies held by such group shall be payable to the group's receiver or other officer of the court.

TITLE II—GROUP PURCHASE OF PRODUCT LIABILITY AND COMPLETED OPERATIONS INSURANCE

EXEMPTION FROM STATE LAW

SEC. 201. In order to promote the group purchase of product liability and completed operations insurance and thereby reduce the cost of such coverage, the persons specified in section 202 shall be exempt from any and all State laws which would—

(1) make it unlawful for insurers to provide or offer to provide product liability and completed operations insurance, or to act or offer to act as agent or

broker with respect to the provision of such insurance, on a group basis, or on any other basis which affords rate, coverage, or other advantages which are not made available to persons who are not members of a group, to the persons described in paragraph (2);

(2) prohibit fictitious groups, groups which have not been in existence for more than some minimum period of time, or groups formed in order to purchase product liability and completed operations insurance on a group basis;

(3) require any policy of product liability and completed operations insurance to be countersigned by an insurance agent or broker residing in that State; or

(4) any other State law which would prohibit or discriminate against the application of this title.

EXEMPT PERSONS

SEC. 202. The following persons shall be exempt from the State laws specified in section 201:

(1) title II groups;

(2) members of title II groups; and

(3) any person who provides product liability and completed operations insurance, insurance-related services, or management services to title II groups and their members.

LIMITATION ON TITLE II EXEMPTION

SEC. 203. The exemption from State laws contained in this title for persons who provide product liability and completed operations insurance to title II groups and their members shall only apply to the provision of, or offer to provide, such insurance to title II groups and their members.

TITLE III—MISCELLANEOUS PROVISIONS

STATE TORT LAW

SEC. 301. Nothing in this Act, including the definition of the term "product liability risk" in section 3(11), shall affect, be construed to affect, or be construed to indicate the desirability of any modifications to, the substantive tort law of any State.

REGULATIONS

SEC. 302. The Secretary shall prescribe such rules and regulations and take all other actions as may be necessary or appropriate to implement this Act.

EFFECTIVE DATE

SEC. 303. This Act shall take effect one hundred and eighty days after the date of enactment.

II

96TH CONGRESS
2D SESSION

H. R. 6152

IN THE SENATE OF THE UNITED STATES

MARCH 12 (legislative day, JANUARY 3), 1980

Read twice and referred to the Committee on Commerce, Science, and Transportation

AN ACT

To facilitate the ability of product sellers to establish product liability risk retention groups, to facilitate the ability of such sellers to purchase product liability insurance on a group basis, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Product Liability Risk Retention Act of 1980".

PURPOSES

SEC. 2. The purposes of this Act are to—

(1) facilitate the formation and sound operation of risk retention groups organized for the primary purpose

of assuming and spreading the product liability or completed operations liability risk exposure of product sellers;

(2) facilitate the purchase of product liability and completed operations liability insurance on a group basis;

(3) reduce insurance costs for product sellers;

(4) ensure the prompt payment of valid claims made by persons injured by products;

(5) promote competition among providers of product liability and completed operations liability coverage; and

(6) reduce the outflow of capital and premiums to offshore jurisdictions which have been attracting captive insurance companies of United States parent corporations.

DEFINITIONS

SEC. 3. As used in this Act:

(1) The term "affiliate" means—

(A) any person who, directly or indirectly, controls or is controlled by another person; or

(B) any person under direct or indirect common control with such other person.

For purposes of this paragraph, the term "control" means ownership or control, directly or indirectly, of more than 50 percent of the total combined voting power of all classes of stock entitled to vote in a corporation or other entity, or actual control where exercised other than through ownership of stock.

(2) The term "approved risk retention group" means a risk retention group which, pursuant to this Act, has been issued a certificate of approval by the Secretary.

(3) The term "completed operations liability" means liability arising out of the installation, maintenance, or repair of any product at a site which is not owned or controlled by—

(A) any person who performs such work; or

(B) any person who hires an independent contractor to perform such work.

Such term shall include liability only for activities which are completed or abandoned before the date of the occurrence giving rise to the liability.

(4) The term "Federal antitrust laws" means—

(A) the laws included within the definition of the term "antitrust laws" under section 1 of the Clayton Act (15 U.S.C. 12); and

(B) the Federal Trade Commission Act (15 U.S.C. 41 et seq.).

(5) The term "group participant" means—

(A) a member of a risk retention group; or

(B) any affiliate of a member whose product liability or completed operations liability risk exposure has been assumed by a risk retention group.

(6) The term "insurance" means primary insurance, excess insurance, reinsurance, surplus lines insurance, and any other arrangement for shifting and distributing risk which is determined to be insurance by the Secretary under applicable State or Federal law.

(7) The term "member" means, only for purposes of title I of this Act, a person who, directly or indirectly, has an interest in a risk retention group as the result of having made a contribution to the capital of such group.

(8) The term "product liability" means liability for damages because of any personal injury, death, emotional harm, consequential economic damage, or property damage (including damages resulting from the loss of use of property) arising out of the manufacture, design, importation, distribution, packaging, labeling, lease, or sale of a product. Such term does not include the liability of any person for such damages if the product involved was in the possession of such person when the incident giving rise to the claim occurred.

(9) The term "risk agreement" means the contract between a risk retention group and one or more group participants thereof, under which the risk retention group agrees to assume a specified portion, or all, of the product liability or completed operations liability risk exposure of any such person.

(10) The term "risk retention group" means any corporation, or other limited liability association taxable as a corporation—

(A) whose principal activity consists of assuming and spreading all, or any portion, of the product liability or completed operations liability risk exposure of its group participants;

(B) which is organized for the primary purpose of conducting the activity described under subparagraph (A); and

(C) which is organized under the laws of a State.

(11) The term "Secretary" means the Secretary of Commerce.

(12) The term "State" means any State of the United States or the District of Columbia.

(13) The term "title II group" means any group which has as one of its purposes the purchase of prod-

uct liability or completed operations liability insurance on a group basis.

TITLE I—RISK RETENTION GROUPS

REQUIREMENTS FOR APPROVAL

SEC. 101. (a) Any risk retention group may submit to the Secretary an application seeking a certificate of approval under this Act. Each application shall be in such form and contain such information as the Secretary, by regulation, may prescribe. Each application shall include—

(1) such information as the Secretary may require to permit the Secretary to evaluate the factors specified in subsection (b); and

(2) a detailed description of the plan of operation of the applicant.

(b) The Secretary shall consider the following factors for purposes of determining the overall soundness of the plan of operation of the applicant:

(1) The amount and liquidity of the assets of the applicant relative to the risks to be retained by the applicant. The assets of the applicant may include irrevocable letters of credit on behalf of the applicant in the form prescribed by the Secretary by regulation and issued by a national bank or a State bank approved for that purpose by the Secretary.

(2) Whether the reserves established, or to be established, by the applicant comply with the requirements of section 104.

(3) The adequacy of the expertise and experience of any person who shall be responsible for the management of the applicant.

(4) The adequacy of the loss prevention programs of the applicant and the group participants of the applicant.

(5) Whether the insurance coverage obtained by the applicant is adequate to satisfy the requirements of section 102.

(6) Whether the applicant has failed to disclose in its application material facts or circumstances bearing upon its qualifications for approval by the Secretary.

(c)(1) Subject to subsection (d), the Secretary shall issue a certificate of approval to any risk retention group which—

(A) has submitted an application under this section; and

(B) is determined by the Secretary, in accordance with standards promulgated by regulation by the Secretary for the purpose of evaluating information contained in such applications, to have a sound plan of operation.

(2) Any refusal by the Secretary to issue a certificate of approval under paragraph (1) shall be made by a written order issued by the Secretary, which order shall specify the reasons for the refusal.

(3) The Secretary shall issue a certificate of approval or issue a written order refusing to issue such a certificate within 90 days after the date of the receipt of the application submitted under this section.

(d)(1) The Secretary shall not issue a certificate of approval to any of the following risk retention groups:

(A) Any risk retention group in which the risk coverage afforded to any one person exceeds 5 percent of the total risks assumed by the risk retention group. For the purpose of determining the risk coverage afforded to any one person, the risk exposure of persons who are affiliates shall be aggregated and considered attributable to only one affiliate.

(B) Any risk retention group which fails to permit, and pay the reasonable cost of, any audits and examinations requested or conducted under subsection (e).

(C) Any risk retention group which, as determined by the Secretary, would exclude any person from membership therein solely to provide for members of such group a competitive advantage over the person excluded from membership.

(2) The Secretary may waive the provisions of paragraph (1)(A) if the Secretary determines that, notwithstanding the failure of the risk retention group to comply with such paragraph, the group is likely to be financially sound and capable of functioning to shift and distribute the risks of its group participants.

(e) In conducting reviews of applications submitted under this section, the Secretary may make such audits or examinations of an applicant and its group participants as may be necessary to determine whether to approve an application submitted under this section. The cost of such audits or examinations shall be paid for by the applicant.

REINSURANCE

SEC. 102. (a) The Secretary may require, as a condition for the approval of a risk retention group, that a risk retention group agree to—

(1) limit the maximum amount of risk it retains (A) in the aggregate, (B) with respect to any one incident, or (C) with respect to one or more of its group participants; and

(2) acquire and maintain insurance coverage for losses in excess of any limitation required under para-

graph (1) by procuring reinsurance which satisfies the requirements of this section.

(b) Any reinsurance policy obtained by an approved risk retention group shall explicitly provide that—

(1) proceeds of the reinsurance policy shall be payable to a receiver or other officer of a court if the risk retention group is determined by a court of competent jurisdiction to be insolvent because it is unable to pay its debts when due; and

(2) the person providing reinsurance to the risk retention group shall give written notice to the risk retention group and to the Secretary of any cancellation or substantial modification of the reinsurance policy not less than 45 days before any such cancellation or substantial modification takes effect.

(c) Any approved risk retention group which has obtained a reinsurance policy shall provide the Secretary with a copy of the policy, the applicable certification of the insurer with respect to the policy, and any documents which substantially modify the coverage afforded under the policy.

(d) No approved risk retention group shall, directly or indirectly, acquire reinsurance from any of its members or from any affiliate of its members.

REQUIREMENTS OF MEMBERSHIP; FEES

SEC. 103. (a)(1) No person shall become a member of an approved risk retention group unless all or a portion of its product liability or completed operations liability risk exposure, or that of one or more of its affiliates, is to be assumed by that group pursuant to a risk agreement.

(2) No person shall continue to be a member of an approved risk retention group for more than 60 days after such group has ceased to assume all or a portion of its product liability or completed operations liability risk exposure, or that of one of its affiliates, pursuant to a risk agreement.

(b)(1) Except as provided in paragraph (2), an approved risk retention group shall not assume, directly or indirectly, the product liability or completed operations liability risk exposure of persons other than its members and affiliates of its members.

(2) An approved risk retention group may assume any product liability or completed operations liability risk exposure of group participants arising from the operation of a hold harmless agreement, an indemnity agreement, or any other similar agreement executed by a group participant and any of the following:

(A) A supplier of products or services to the group participant.

(B) A purchaser of products or services from the group participant.

(C) A person who holds the products of the group participant on consignment for sale.

(c) An approved risk retention group may not make non-pro-rata assessments or retroactive adjustments, based on an individual group participant's loss experience, to the fees paid by such group participant for coverage.

(d) The Secretary shall prescribe regulations which provide for the return of the capital contribution of any person who withdraws from an approved risk retention group. These regulations shall provide that—

(1) the withdrawing member's capital contribution shall be increased or decreased, as appropriate, to reflect the claims experience (including incurred but not reported losses), earnings, losses, and distributions of the group, all determined through the application of generally accepted accounting principles, during the period the withdrawing person was a group member; and

(2) the member's adjusted capital contribution shall be returned, together with interest at the rate provided for in the risk agreement, or if no rate was provided for, at the prevailing prime rate in the United States, accruing from the date of withdrawal, in in-

stallments over such a period of time as is necessary (but not longer than the 5-year period beginning on the date of withdrawal) in order to determine the appropriate adjustments under paragraph (1), without jeopardizing the financial condition of the group.

(e) No approved risk retention group shall, directly or indirectly, acquire any securities of, make or guarantee any loans to, receive loans from, or otherwise acquire any interest in, any of its members or affiliates of its members.

RESERVES

SEC. 104. (a) The Secretary shall require an approved risk retention group to establish and maintain reasonable and adequate reserves to meet incurred losses (including losses which have not been reported) and loss adjustment expenses. The Secretary shall not permit such reserves to exceed levels determined through computations using accepted actuarial methods and based on reasonable actuarial assumptions.

(b)(1) In addition to the reserves required under subsection (a), the Secretary shall require an approved risk retention group to establish and maintain a reasonable and adequate reserve for unearned premiums paid or to be paid to the group by its group participants. Such reserve shall not be less than 50 percent of the annual net premiums paid or to be paid to the group by its group participants. Each approved risk retention group shall include this reserve and the reserves required under subsection (a) as a liability in all its financial statements.

(2) As used in paragraph (1), the term "net premiums" means the difference between—

(A) the aggregate amount of premiums received by an approved risk retention group as consideration for assuming and retaining the risks of its group participants (exclusive of nonrecurring items, such as contributions to capital); and

(B) the sum of—

(i) amounts returned to group participants of such risk retention group (other than in payment for covered losses) such as risk-agreement dividends, refunds, and returns for risk-agreement cancellations; and

(ii) the portion of the gross compensation of the group which is allocable to risks ceded to excess insurers or reinsurers.

(c) The reserves of an approved risk retention group shall be invested in the same manner and with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

ANNUAL AND OTHER REPORTS

SEC. 105. (a) Each approved risk retention group shall submit to the Secretary an annual report and such other reports as the Secretary considers appropriate in order to carry out the purposes of this Act, except that the Secretary shall insure that the number of reports required by the Secretary under this subsection does not constitute an undue burden upon approved risk retention groups. An approved risk retention group may be required to provide in such reports any information relevant to the administration of this Act which is in the possession, or subject to the control, of the risk retention group or its group participants.

(b) The reports required to be submitted pursuant to this section shall be in such form and contain such information and certifications as the Secretary, by regulation, may prescribe. The annual report shall include a statement of financial condition and operations substantially similar to the annual statement approved by the National Association of Insurance Commissioners.

(c) Each approved risk retention group shall submit to the Secretary information regarding any change in the plan of operation of such group from the plan described in the application submitted under section 101.

APPLICABILITY OF STATE LAW

SEC. 106. (a) This Act shall preempt any State law to the extent that such law would—

(1) make unlawful the formation or operation of approved risk retention groups;

(2) regulate, directly or indirectly, the formation or operation of approved risk retention groups with respect to—

(A) the assumption, spreading, or ceding of all, or any portion, of the product liability or completed operations liability risk exposure of their group participants;

(B) any functions related to the activities described under subparagraph (A); or

(C) such other functions conducted by an approved risk retention group as are permitted by the Secretary;

(3) make it unlawful for any person to provide or sell product liability or completed operations liability insurance, insurance-related services, or management services to an approved risk retention group; or

(4) regulate, directly or indirectly, the provision or sale of product liability or completed operations liability insurance, insurance-related services, or management

services by any person to an approved risk retention group.

(b) Nothing contained in this Act shall be deemed to bar a State from collecting, on a nondiscriminatory basis, from an approved risk retention group applicable premium and other taxes which are levied on admitted insurers and surplus lines insurers under State law.

(c) Not later than the date this Act takes effect, the Secretary shall promulgate regulations containing requirements with respect to claims settlement practices of approved risk retention groups. In formulating such regulations, the Secretary shall take into consideration the provisions of State laws respecting claims settlement practices.

APPLICATION OF ANTITRUST LAWS

SEC. 107. (a) Notwithstanding any other law, the Federal antitrust laws shall be applicable to approved risk retention groups, their group participants, activities of risk retention groups and their group participants, and to any person engaged in such activities (including persons providing management services to such groups).

(b) Nothing contained in this Act shall be deemed to create any immunity or defense to any civil or criminal action under any Federal antitrust law.

APPLICATION OF SECURITIES LAWS

SEC. 108. (a) The ownership interests of members in approved risk retention groups shall not be considered securities for purposes of the Securities Act of 1933 (15 U.S.C. 77a et seq.) or for purposes of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(b) Approved risk retention groups shall not be considered to be investment companies for purposes of the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.).

DISCLOSURE OF INFORMATION

SEC. 109. (a)(1) The Secretary, any other officer or employee of the Department of Commerce, and any person referred to in section 110(c), shall not—

(A) use the information furnished under this Act for any purpose other than the administrative or statistical purposes for which it is supplied;

(B) disclose any data obtained pursuant to this Act that is exempt from disclosure under section 552(b)(4) of title 5, United States Code; or

(C) permit any person, other than officers or employees of the Department of Commerce or any person referred to in section 110(c), to examine any application or report submitted under this Act.

(2) Nothing contained in paragraph (1) of this subsection shall limit the access of the Congress to any information re-

ferred to in such paragraph if such information could be obtained by the Congress under any law or other authority.

(b) Copies of applications or reports which have been submitted under this Act, and copies of applications submitted by any person seeking membership or participation in an approved risk retention group, may not be compelled to be disclosed, and cannot be admitted in evidence, in any administrative or judicial proceeding related to the adjudication of a product liability or completed operations liability claim brought against any risk retention group which has submitted an application under section 101 of this Act or its group participants. Notwithstanding the preceding sentence, such applications or reports may be disclosed or admitted in evidence in such proceedings with the consent of the person or persons whom such applications or reports concern.

(c) The Secretary may require each approved risk retention group to collect and provide to the Secretary such data regarding its product liability and completed operations liability claims experience as the Secretary may consider appropriate. Notwithstanding subsection (a), the Secretary may disclose the data collected pursuant to this section in a format which does not directly or indirectly identify the individual product liability claims experience of any group participant of an approved risk retention group.

AUDIT AND MANAGEMENT

SEC. 110. (a) The financial records of each approved risk retention group, its members, and the affiliates of its members may be audited or examined by the Secretary in order to gather information relevant to the administration of this Act. The Secretary, or any duly authorized representative of the Secretary, shall have access for the purpose of the audit or examination to any books, documents, papers, and records of such groups, members, or affiliates (or any agent thereof) which the Secretary considers relevant to the formation or operation of the approved risk retention group. Such audits and examinations may be conducted without advance notice at such times as the Secretary may determine to be appropriate.

(b)(1) The Secretary may require that each approved risk retention group engage an independent certified public accountant to conduct such examination of financial statements of the group (and of other relevant books, documents, papers, and records of the group) as the accountant may consider necessary to enable the accountant to determine whether the financial statement and schedules of the group are presented in conformity with generally accepted accounting principles applied on a basis consistent with the accounting method employed by the group during the preceding year. Such examinations shall be conducted in accordance with generally accepted auditing standards and shall involve such tests of the books and records of the group as are considered necessary by the accountant.

(2) In administering this Act, the Secretary may rely upon financial statements prepared by independent certified public accountants for approved risk retention groups in lieu of conducting audits or examinations under subsection (a), but only if such statements—

(A) are prepared in the manner described in paragraph (1); and

(B) were prepared in response to a request therefor made by the Secretary or were prepared within a reasonable time before such request.

(c) In administering this Act, the Secretary may utilize personnel of other agencies of the Federal Government, or personnel of State or local governments, subject to the consent of the heads of the entities involved. The Secretary also may utilize employees of private organizations to perform ministerial functions under this Act, such as conducting audits and examinations.

ADMINISTRATIVE FEES

SEC. 111. (a) Each applicant for approval under section 101 shall pay to the Secretary a nonrefundable application fee to cover the cost of processing an application for a certificate of approval. This fee shall be in addition to any amount required under section 101(e).

(b) The Secretary shall establish and collect from each approved risk retention group a nonrefundable annual fee in an amount sufficient to reimburse the Secretary for the direct costs of supervising the approved risk retention group.

(c) There is established in the Treasury a revolving fund which shall be available to the Secretary, without fiscal year limitation, to carry out this Act. There shall be deposited in the fund amounts received by the Secretary under this section and under section 101(e).

REVOCATION OF APPROVAL

SEC. 112. (a) The Secretary may revoke the certificate of approval of an approved risk retention group—

(1) upon the request of the group;

(2) upon the refusal of the group to permit an audit or examination of its books and records pursuant to section 110;

(3)(A) upon the violation by the approved risk retention group of any provision of this Act, or any regulation promulgated under this Act; or

(B) upon a determination by the Secretary that the risk retention group has altered its plan of operation in such a manner that the Secretary would not have approved the application of the risk retention group if the plan of operation had been submitted in the application in such altered form;

(4) upon the Secretary's determination that the group is primarily engaged in the business of investing, reinvesting, or trading in securities; or

(5) upon the Secretary's determination that the primary purpose or principal activity of the group has ceased to consist of assuming and spreading all, or any portion, of the product liability and completed operations liability risk exposure of its group participants.

(b) The Secretary may not revoke the certificate of approval of a risk retention group unless the Secretary provides—

(1) to the risk retention group not less than 30 days' written notice of the intention of the Secretary to revoke such certification, including a statement of the reasons for the proposed revocation;

(2) an opportunity, during such period, for the risk retention group to correct any alleged deficiencies in its operation identified in the written notice as grounds for revocation; and

(3) upon the written request of such group or any group participant thereof, an opportunity for an informal hearing, to be held before the revocation of the certification, to appeal such proposed revocation.

(c) The Secretary may revoke a certificate of approval only by written order. Any such order shall be served upon the risk retention group and shall set forth the reasons for the revocation.

(d)(1) Any risk retention group whose certificate of approval is revoked under this section shall commence dissolution proceedings under the applicable laws of the State in which the group is incorporated within 30 days after such revocation. The Secretary shall take such action as may be necessary to ensure compliance with this paragraph. Under the State dissolution proceedings, the return of the capital contributions of members of the group shall be done in a manner consistent with paragraph (2) of this subsection.

(2) Any risk retention group whose certificate of approval is revoked under this section shall provide for the return of capital contributions to its members in installments, payment of which shall be completed not later than the date 3 years after the date of revocation of the certificate. The Secretary shall determine the amount of the members' capital contributions which are to be returned, which amount shall be increased or decreased, as appropriate, to reflect the claims experience (including incurred but not reported losses), earnings, losses, and distributions of the risk retention group, as determined by the Secretary through the application of generally accepted accounting principles.

HEARINGS AND JUDICIAL REVIEW

SEC. 113. (a) Any revocation hearing provided for under section 112(b)(3) shall be informal and shall be held in the District of Columbia. The Secretary shall promulgate regulations which specify the persons who may participate in such hearings.

(b) Any order issued by the Secretary pursuant to this Act shall be final except that an approved risk retention group, an applicant for a certificate of approval, or a group participant of such group or applicant, may appeal any order by filing in the United States District Court for the District of Columbia, within 60 days after the date of service of such order, a written petition requesting that the order of the Secretary be modified, terminated, or set aside. Such order shall be reviewed in accordance with the provisions of section 706 of title 5, United States Code.

TITLE II—GROUP PURCHASE OF PRODUCT LIABILITY INSURANCE AND COMPLETED OPERATIONS LIABILITY INSURANCE

EXEMPTION FROM STATE LAW

SEC. 201. The persons specified in section 202 shall be exempt from any State law to the extent that such law would—

(1) make it unlawful—

(A) for insurers to provide or offer to provide product liability or completed operations liability insurance on a basis which provides, to title II groups or members thereof, advantages not afforded to other persons with respect to rates, coverage, or other matters; or

(B) to act, or offer to act, as an agent or broker with respect to the provision of such insurance on such basis to title II groups or members thereof;

(2) prohibit the establishment of any title II group;

(3) prohibit any title II group or member thereof from purchasing product liability or completed operations liability insurance on the basis described in paragraph (1)(A), provide that such group may not purchase such insurance on such basis unless the group has been in existence for a minimum period of time, or provide that a member of such group may not purchase such insurance on such basis unless the member has belonged to the group for a minimum period of time;

(4) require that any policy of product liability or completed operations liability insurance provided to any title II group or member thereof be countersigned

by an insurance agent or broker residing in that State; or

(5) otherwise discriminate against title II groups or members thereof.

APPLICATION OF EXEMPTIONS

SEC. 202. The exemptions specified under section 201 shall be applicable with respect to—

(1) any title II group;

(2) any person who is a member of a title II group; and

(3) any person who provides product liability or completed operations liability insurance, insurance-related services, or management services to any group or person described in paragraph (1) or (2).

TITLE III—MISCELLANEOUS PROVISIONS

STATE TORT LAW

SEC. 301. Nothing in this Act shall affect the tort law of any State. The provisions of this Act shall not be construed to express the sense of the Congress regarding the desirability of modifying the provisions of the tort law of any State.

REGULATIONS

SEC. 302. The Secretary shall prescribe such rules and regulations as may be necessary or appropriate to implement this Act.

REPORT TO THE CONGRESS

SEC. 303. The Secretary, not later than 150 days after the date of the enactment of this Act, shall submit a report to the Committee on Interstate and Foreign Commerce of the House of Representatives and the Committee on Commerce, Science, and Transportation of the Senate which shall contain a detailed statement of the Secretary's preparations and other activities to implement this Act.

EFFECTIVE DATE

SEC. 304. (a) This Act shall take effect on the date 180 days after the date of its enactment.

(b) Title I of this Act shall cease to be in effect on the date 4 years after the effective date of this Act, but only if, on such date, there exists no approved risk retention group.

Passed the House of Representatives March 10, 1980.

Attest: EDMUND L. HENSHAW, JR.,

Clerk.

By W. RAYMOND COLLEY,

Deputy Clerk.

The CHAIRMAN. The first witness will be Mr. Homer Moyer, General Counsel, Department of Commerce.

STATEMENT OF HOMER E. MOYER, JR., GENERAL COUNSEL, DEPARTMENT OF COMMERCE; ACCOMPANIED BY GEORGE NEIDICH; VICTOR SCHWARTZ; AND EDWARD BARRETT

Mr. MOYER. Thank you, Mr. Chairman. First, I would like to express my appreciation to you on behalf of the Department for responding to Secretary Klutznick's request to hold hearings promptly on the Product Liability Risk Retention Act. We also appreciate your holding these hearings at the full committee level.

I would like to use my time this morning to stress the need to act on the Product Liability Risk Retention Act in this session. Secretary Klutznick strongly supports this view. I would like to share with you our reasons for urging your prompt action on this matter.

A Federal interagency task force and congressional and State legislative hearings and studies all show that product liability insurance has become unaffordable for many businesses, especially small businesses. For example, presently over one-eighth of the machine tool industry is operating without any product liability insurance at all. This is a situation that is of concern to both product users and sellers: If a business is operating without insurance, one adverse judgment can cause it to close its doors; if a business is operating without adequate product liability coverage, an injured consumer may be unable to enforce a just claim.

As I will detail in a moment, the Product Liability Risk Retention Act will ameliorate this situation by adding needed capacity to the product liability insurance market. Moreover, it will be on call in case the product liability situation gets worse in the future.

What is the present market situation with respect to product liability insurance?

During the period 1974-77 product liability premiums increased literally hundreds of percentage points for many companies. Recently we have been in a period of apparent stabilization. While rates, at least actuarially developed rates, have not increased, premiums have continued to rise reflecting increased sales and other factors. Deductibles have increased for many businesses with the result that the premium dollar is buying less protection. More importantly, there are signs that suggest the situation will grow worse in the future.

First, last year the property/casualty insurance industry reported substantial underwriting losses. Authoritative persons in the insurance field have predicted a continued downswing in the insurance market. The last time there was such a downswing, product liability premiums increased sharply.

Second, there has been a new generation of case law in the past 2 years that further expands liability on the part of product sellers. For example, just a few weeks ago, the Supreme Court of California broke new ground in the *Sindell* case and held pharmaceutical manufacturers subject to liability even though persons who brought the claim could not identify which manufacturer had caused their alleged injuries.

What has caused product liability insurance costs to burgeon?

The Federal interagency task force, two House committees, and all State studies have found that overly subjective insurance ratemaking practices is a major cause. Given this conclusion, the administration had two options. One possible remedy would have been to create a Federal regulatory presence in the area of commercial insurance regulations; in other words, the Federal Government could have attempted to tell insurers what data should be collected and what should be done with those data. That approach has its proponents.

Our department and the administration rejected this approach. Instead, we adopted the Risk Retention Act as a market, rather than a regulatory, solution.

The act seeks to assure that insurance rates accurately reflect product risk. It does so by promoting increased competition in the insurance market. It accomplishes this goal by permitting product sellers to form self-insurance cooperatives called risk retention groups. These groups may cover all or a portion of their members product liability risk. The groups would apply to the Department of Commerce for a charter. The Department would review whether the groups were adequately capitalized and managed before any charter would be issued. The act also permits product sellers to purchase product liability insurance on a group basis.

State insurance regulations in most States prohibit group purchase of insurance and render self-insurance by product sellers not feasible. For this reason, Federal action is necessary.

We have supplied the committee with a statement of purpose and need which supports this conclusion.

The Risk Retention Act will be of special utility to small- and nedium-size businesses. In that regard, we noted with interest that Senator Nelson's Senate Task Force on Small Business listed product liability as one of the major problem areas for small business. t is indeed the small- and medium-size businesses that have borne he major burden of product liability insurance costs and availabil-ty problems. Larger companies generally employ risk managers vho are skilled at negotiating more favorable insurance terms, or hey may have alternatives such as overseas captives.

Let me close, Mr. Chairman, by emphasizing a few major points bout the Risk Retention Act. Professor Schwartz, who is accompa-ying me this morning, will provide further details on these mat-ers if the committee so desires.

The act is deregulatory; it eliminates State barriers which pre-ent businesses from forming self-insurance groups. Existing State nsurance regulations constitute an insurmountable barrier be-ause these groups will have members in more than one State. herefore, the insurance regulations of each of the members' tates must be followed—a costly burden for these limited purpose nsurer groups.

Participation under the act is entirely voluntary. Product sellers nay form groups only if they wish. They may retain risks to the xtent they think necessary. Reinsurers are not required to supply uch coverage to the groups.

The act does not preempt State regulations of commercial insur-rs. The immunity of commercial insurers from the Federal antitrust laws under the McCarran-Ferguson Act is not altered in any way.

The act will be self-supporting through fees paid by applicants.

No large bureaucracy will be created by the act. Risk retention groups will be managed by businesses with the assistance of experts in the insurance community.

The act will not reduce State revenues. Risk retention groups will be subject to applicable State insurance taxes.

The act as passed by the House has a useful sunset provision. If it is not utilized by product sellers, title I of the act will expire.

The act is the only major product liability remedy that has drawn broad based support from both product sellers and consumer groups.

Finally, the act received overwhelming support in the House of Representatives—support that crossed party, geographical, and ideological lines—and the House acted on a firm and thorough record compiled by the Subcommittee on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee.

As Professor Schwartz will detail, the administration recognizes that insurance ratemaking practices are not the only cause of the product liability problem. Continued uncertainties and occasional imbalances in the tort system have also been a cause. We have addressed those issues through the Model Uniform Product Liability Act that we have recommended for adoption by the States.

As long ago as 1976, when Senator Culver held the first congressional hearings about product liability, he noted that each of the various interest groups differs as to the causes of its product liability problems.

Insurers allege that uncertainties and imbalances in the tort litigation system are the sole cause. Consumers and the plaintiff's bar state that insurance ratemaking practices are the sole cause. From our perspective we believe that both are important causes of the problem.

The Risk Retention Act provides a vehicle whereby the Federal Government can help ease the situation now and in the future. As a very recent editorial in Business Week observed, it is "an informed solution to a problem that troubles business" and it will help resolve the "immediate problem."

For that reason, we very much welcome your holding these hearings and hope that you will act favorably on the proposal. Thank you.

The CHAIRMAN. Thank you.

Professor Schwartz, we will put your entire statement in the record. Why don't you summarize from it very briefly, and then we'll go to the questions, because we do have many of them.

Mr. SCHWARTZ. I would just briefly add that we have heard from a variety of constituent groups. Property-casualty insurance trade associations, as you will hear in the hearings, are concerned about this act. Nevertheless, it is not an attempt in any way to impede their method of doing business. In fact, we believe insurers can provide assistance to risk retention groups through management services and better packaging of insurance than exists today.

With respect to a final point that Mr. Moyer made, we do not believe that insurance ratemaking practices are the sole cause of the problem. Our Uniform Product Liability Act has been considered by seven State legislatures since it was first issued in January and we are pursuing and addressing the tort aspect of the product liability problem as well.

[The statement follows:]

STATEMENT OF VICTOR E. SCHWARTZ, CHAIRMAN, TASK FORCE ON PRODUCT LIABILITY AND ACCIDENT COMPENSATION, DEPARTMENT OF COMMERCE

Thank you for your invitation to testify today regarding the Product Liability Risk Rentention Act. Let me expand upon several points made by Mr. Moyer.

The Risk Retention Act will help product sellers address their product liability problems in two ways. First, Title I of the act enables product sellers to form their own insurance cooperatives called "risk retention groups." Members of these groups will be able to pool all or a portion of their product liability exposure. These groups will be exempted from State insurance regulation. These regulations are directed at commercial insurers that deal with the public, but have had the practical effect of preventing product sellers, located in different States, from forming self-insurance groups.

Second, Title II of the act will enable product sellers to negotiate with commercial insurers as a group for premium discounts and other benefits which otherwise would not be available to the firms individually.

We believe that the Risk Retention Act will reduce insurance costs for product sellers, particularly small companies which have had good claims experience, but do not benefit from this experience. Large companies can expect to benefit not only from the increased competition in the insurance market but also directly from the reduced costs incurred by their suppliers and distributors.

The act will also promote increased competition among insurance companies. it will help insure the payment of claims brought by persons injured by defective products. Finally, it will create a U.S. alternative to "going offshore" to create a group self-insurance entity.

Enactment of the Risk Retention Act will accomplish these objectives with no cost to the Federal Government, as was confirmed by the Congressional Budget Office's review of the bill. Instead, the expenses for the program will be borne by the risk retention groups themselves through application and annual fees.

Furthermore, the act will achieve these goals without increasing government regulation. The act reduces regulation. It creates a voluntary program. It merely permits business to form risk retention groups or to purchase commercial insurance on a group basis.

Businesses seeking to avail themselves of the opportunities created by the Act will not confront a regulatory maze at the Commerce Department. In fact, there will be no federal regulation of the groups formed to buy commercial insurance collectively. With respect to risk retention groups, the Secretary of Commerce, who will administer the Act, will ensure that a risk retention group has adequate assets to meet the risks that the group wishes to retain. The Secretary is directed by the Act to look at various factors, including the group's assets, its management, its reserves, and its loss prevention programs.

Most of the "business" decisions involved in forming a group will be left to the marketplace. In that regard, the Act relies heavily on the self interest of each member of a risk retention group to assure its proper management. Furthermore, the Act requires that expert and experienced management be retained by the groups.

A fundamental question about the Risk Retention Act is: why is Federal action necessary? The rationale for Federal action is the inability of individual states to effectively encourage product liability group self-insurance. Due to the geographical dispersion of product sellers, product liability self-insurance groups normally will have members in more than one state. Such groups, therefore, must comply with the insurance regulations of more than one state. As I mentioned before, these regulations create insurmountable barriers to the groups. For example, they include financial requirements which are not related to the amount of risk retained by the groups. They also include minimum operating periods (e.g., in California, three years) before a group formed in one state can service members in another state. Most importantly, in many states there are laws which would prevent the groups from competing as to price and coverage with insurers licensed in the state. This, of course, is the purpose of forming groups in the first place.

It should be noted that two states, Colorado and Tennessee, have attempted to facilitate self insurance by enacting captive insurance enabling legislation. Captives formed in those states (and to our knowledge, only 30 have been formed in Colorado and 1 in Tennessee—compared with the approximately 750 formed in Bermuda) could facilitate self-insurance groups operating solely within the borders of the licensing state. They cannot, however, eliminate the aforementioned regulatory impediments created by the insurance laws of other states. These laws will come into play when the captive insurance company transacts business or adjusts claims outside of its licensing state. We understand that many Colorado captives use commercial insurers in a "fronting" arrangement in order to avoid these regulatory impediments. Such arrangements are often impractical for small companies attempting to form a self insurance group.

In all events, while some insurer trade associations have indicated concern about the proposal, it was designed with the hope that insurers would not be in opposition to its enactment. First, it is not intended to create a situation in which a risk retention group would have an unfair competitive advantage over a commercial insurer. Let me share with you why this is so.

Risk retention groups will be subject to the same state insurance premium taxes paid by insurers.

The groups will be subject to similar, and in some cases more stringent, requirements as those which commercial insurers must meet. With regard to the similar requirements, approved groups must meet minimum financial and management standards. Also, they will have to maintain proper reserves. These requirements will assure that the groups will be able to meet covered claims brought against their members.

Approved groups will be subject to more stringent requirements in several cases. Unlike commercial insurers, approved groups will be subject to the Federal antitrust laws, and they will not be permitted to make non-pro-rata assessments or retroactive adjustments to premiums paid by their members. Approved groups will be limited to offering only product liability and completed operations insurance. Commercial insurers, in contrast, are authorized to issue policies for general liability, as well as other commercial lines.

Second, the Act will not take business away from insurers. In fact, insurers will profit from it. They will be able to earn fees from providing consulting services to risk retention groups. Also the Act creates new ways for insurers to meet their customers' insurance needs.

Finally, the Act does not in any way regulate commercial insurers, nor does it affect their McCarran-Ferguson antitrust exemption. It simply creates a competitive alternative—a safety valve for product sellers who cannot obtain adequate insurance coverage, or who cannot afford the coverage available in the existing commercial market. The Act will moderate the impact of the imminent downturn in the insurance underwriting cycle, forecast by some insurance experts, by creating new underwriting capacity. This will help insureds in any new "capacity crunch" similar to the one that occurred in 1974–75.

In sum, the Act will help insurance underwriters, agents, and brokers meet the needs of their customers without creating unfair competition problems within the insurance industry.

Federal action to facilitate product liability group self-insurance—which is at the heart of the Risk Retention Act—is the only major product liability approach that has been endorsed by groups representing large and small business, consumers, and the plaintiffs' bar.

I will be happy to answer your questions concerning the Risk Retention Act.

The CHAIRMAN. Thank you, Professor Schwartz.

Mr. Moyer, in your statement you say that knowledgeable persons in the insurance field have predicted a continued downswing in the insurance market. The last time there was such a downswing, product liability premiums increased sharply.

Yet you go on to argue that by going in this fashion—the risk retention bill—you can reduce the costs substantially. If the losses have been increasing and there is a downswing in the insurance market, how do you reconcile those two positions?

Mr. MOYER. My comments, Mr. Chairman, with respect to the benefits of the risk retention groups and opportunities for group purchasing of product liability insurance address what the cost phenomena would be for small- and medium-sized businesses to

pages tightly bound

engage those types of groups and those types of opportunities. At present most small businesses do not benefit from having a good claims experience.

With respect to the larger insurance market and whether it has a downswing or not, that comment, Mr. Chairman, goes simply to the extent to which we are likely to have a recurrence of the very dramatically risking product liability insurance premiums that we saw a few years ago. At that time rates rose dramatically, although there was no demonstration that the number or size of product liability claims had increased.

Mr. CHAIRMAN. And you say that the act would promote increased competition in the insurance market. Isn't that a little inconsistent, too, with what you said in the first part of your statement?

Mr. MOYER. I think not, Mr. Chairman, in that risk retention groups, insurance cooperatives in essence, would introduce new capacity into the insurance market. Also the act would provide a new and significant competitive force in the insurance market: It would place pressure on commercial insurers to price their policies in accord with actual product risk.

The CHAIRMAN. You also say that insurers allege that uncertainties and imbalances in the tort litigation system are the sole cause of product liability problems. And consumers and the plaintiff's bar claim that insurance ratemaking practices are the sole cause.

Will that change? If those two things are alleged to be the sole causes in this area, will that situation change if you go in the fashion that you are suggesting?

Mr. MOYER. This, as I indicated, Mr. Chairman, would not be a complete response. It is not a total response to the product liability insurance problem, as we have seen in the last several years. It addresses the overly subjective insurance ratemaking problem and as to that element we think it is the best solution.

It does not address the problems in the tort system. We have undertaken a separate initiative to deal with that issue and that set of problems.

Quite frankly, as we proceeded through this process and talked with a very large number of interest groups, we have had a variety of suggestions as to what the sole or principal causes have been. Those diagnoses tend to vary with the group with whom we're speaking. In setting forth public policy we have had to take an objective overview.

The CHAIRMAN. Does the administration feel there is an immediate need for adoption of the Product Liability Risk Retention Act?

Mr. MOYER. Yes, Mr. Chairman, we do.

The CHAIRMAN. Is the Department of Commerce equipped to administer the act if it is enacted?

Mr. MOYER. Yes, Mr. Chairman, it is. As I mentioned, the resources involved will be quite small. A staff of approximately six professionals is our best estimate at this time. The Department has extensive experience in this area, in particular through the conduct of this interagency task force on product liability. Also, we chair the interagency council insurance and accident compensation. And the Department has experience in war risk and maritime insurance areas.

I think the answer is, yes, we can competently handle that.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. No questions.

The CHAIRMAN. Senator Stevenson?

Senator STEVENSON. Thank you, Mr. Chairman.

This act appears to recognize that product liability costs and the insurance against the risks of product liability are in some instances driving business offshore and putting American manufacturers to competitive disadvantages, aggravating the trade deficit. And yet, as I understand it, all it does is help to reform the insurance against product liability risk. It doesn't address the risks.

I should think it would be more efficient and economically sound not to tamper with insurance, but to go directly to the cause of the problem, which is excessive risk. The courts, I understand, with arguable authority, have virtually repealed the tort laws in this area, the laws of warranties. And yet we aren't addressing the law.

Why wouldn't it be much more direct and effective to reform the tort law instead of the risks associated with those?

Mr. MOYER. Let me answer that, Senator.

Senator STEVENSON. Is this act addressed at all to the underlying risk ostensibly at which the insurance is directed?

Mr. MOYER. Yes, it is. It is in this way. Part of the product liability insurance problem that we have seen as we have analyzed this over some period of time is the extent to which claims experience are reflected in product liability insurance rates and premiums. A central concept in these risk retention groups or cooperatives and in group purchasing for small- and medium-sized businesses is that they will be able to achieve protection at costs that are more directly related to their actual claims experience. That goes directly to the question of risks, in that it encourages product liability loss prevention and the minimizing of risks and provides and effects positive feedback in the form of lower costs to those companies.

A cooperative that consists of small- and medium-sized companies with superior claims experience and minimal risks in their products would stand to benefit by the formation and acquisition of protection through one of these two devices in a way that our analysis shows they generally do not now. So I think it does in that sense directly relate to risk.

As to the part of your question relating to tort law, we certainly agree that that is an element, an important element of the problem. We have gone through a similar analysis with respect to changes in the tort law. There have been some rapid changes in the law. Also, there are significant variations from State to State. Our judgment was that a different type of solution was more appropriate to the tort law problem, namely the promulgation of a model tort law which we would make available to States. And that indeed is what we have done.

So in response to your question, we are not at all unmindful of that part of the problem and have actively pursued it. We are not seeking Federal legislation with respect to it.

Senator STEVENSON. How does this act minimize the risks of a manufacturer's product liability? You said it minimized risks. I still don't understand your answer of how it does that.

Part of your answer, the answer with respect to tort liability, indicates that it does not minimize the risks of tort liability.

Mr. **Moyer**. It operates—it does not, of course, affect any company's exposure under the relevant tort law standards for the State in which it's operating. That of course is separate.

But what it does do is create a greater responsiveness between—a greater, closer relationship between cost of protection and an individual company's or group of companies' claims experience. If there are safer products, if there are fewer or no claims for product liability incidents, that company or that group of companies can minimize costs of obtaining protection, and thereby that in turn influences both the cost experience and the extent to which their product claims experience ties into their protection.

Senator **Stevenson**. Well, instead of more tinkering in this case by regulating the insurance, why don't we go directly to the cause of the problem, which is the tort law, and do so directly in this act and recognize that there is a problem? Why don't we do something about it?

Mr. **Schwartz**. Uncertainties and occasional imbalances in tort law are a very important part of the problem. If tort law rules are changed—they have been changed in some States; already two States have adopted portions of the Uniform Act—we need an assurance that the savings that are wrought by the tort law changes will be passed on to product sellers. And that assurance is needed by product sellers throughout this country.

We have to go back to the interagency study, which found the overly subjective insurance ratemaking practices were a cause of the problem. This finding suggests that although States enact tort law changes which reduce the costs of a number of claims and the size of claims, the savings generated these changes will not necessary be passed on to the product sellers who purchase insurance.

Going back again some time ago, an estimate was made by the Insurance Information Institute that 1 million claims were filed in 1976. Yet when the Insurance Services Office, which is the leading ratemaking group for the insurance industry, counted closed claims, their estimate was that there were only 70,000 to 100,000 claims.

What is needed is some assurance, a bellwether, so to speak, that savings wrought by tort law reform are passed along to individual product sellers.

A second point about risk: Reducing risk doesn't really come about through tort reform. All tort reform does is reduce the number of claims and make the system more predictable. You reduce risk through product liability loss prevention. We believe that the Risk Retention Act, wherein people are self-insuring and their own assets are more immediately exposed to claims, will encourage companies to develop and enforce more product liability loss prevention programs. This in turn will help reduce risks of hazards to persons who purchase products.

Senator **Stevenson**. If, as you say, the purpose of this act is to distribute the savings from tort law reform fairly, why don't we assure that there are such savings to in fact be distributed by the act? You are beating around the bush.

Mr. **Schwartz**. Well, a lot of time was spent to draft the Uniform Product Liability Act which was supplied to this committee. We have already testified about that act in several States, including California, which is a major State in regard to product liability claims.

The only thing we haven't done is promote or suggest that the Uniform Product Liability Act be enacted at the Federal level. The reason we have not done that is the tort law traditionally has been the province of the States.

Senator **Stevenson**. So is insurance regulation.

Mr. **Schwartz**. That is right. That is why we did not suggest commercial insurers be regulated in any way.

The difficulty in forming self-insurance groups comes about that product sellers usually must form groups whose individual members are domiciled in different States. And this matter has been looked at very, very carefully, and it is virtually impossible—not impossible, but virtually impossible—for medium and smaller businesses from different States to quickly and effectively form self-insurance groups.

Now, there is the possibility, as I am sure witnesses from the insurance industry can suggest to you, that if some of the larger States engage in tort reform efforts, this action can be effective in stabilizing product liability insurance rates and premiums, and that Federal action is not absolutely necessary in this area.

Senator **Stevenson**. I won't prolong it. I just think it's difficult for sellers and manufacturers to deal with some 50 different sets of product liability laws and workmen's comp laws. And that we don't do anything that is supposed to be done in this bill about the basic underlying problem, which is the risk.

Mr. **Schwartz**. Others have shared your view. And as you probably are aware, tomorrow in the House there will be hearings on H.R. 7000, which is a Federal bill that was modeled after our Uniform Product Liability Act. And because there is considerable Interstate Commerce connections in the tort reform, we know some people believe you need Federal action in the tort area, too. We will supply you with more information about this matter.

[The following information was subsequently received for the record:]

U.S. Department of Commerce,
Office of the Secretary,
Washington, D.C., April 25, 1980.

Hon. Adlai E. Stevenson,
U.S. Senate,
Washington, D.C.

Dear Senator Stevenson: After reviewing the transcript of the Committee on Commerce, Science, and Transportation's hearing on the Risk Retention Act, I thought it might be helpful to you if our Department supplied some additional information in regard to the questions that you asked.

You inquired whether the Risk Retention Act would reduce the number or size of product liability claims. Transcript at Page 16.

A simple answer to this question is it does not. In light of that fact, you inquired, "why hasn't the Department gone directly to the cause of the problem, which is tort law * * *." It is this point that needs more clarification.

First, the Department has developed the Uniform Product Liability Act as a model for state legislation. A number of states have enacted tort law reform in this area and the model Act should encourage more to do so. Although the model Act has only been in the public realm for a few months, two state legislatures have already turned to it as a source of law.

While the Administration has indicated that it should be only a model for the states, we appreciate the fact that some members of Congress believe that it should be the basis for federal standards. In light of your interest in this topic we have forwarded to your office copies of our comments on the principal bill of this type (H.R. 7000) as well as testimony that we recently presented to the House Interstate and Foreign Commerce's Subcommittee on Consumer Protection and Finance about the proposal's details.

Second, while tort law changes, rather than the Risk Retention Act, may reduce the number and size of claims, the Act is absolutely essential to any solution to the entire product liability problem. The reason for this is that no one has ever demonstrated that the huge increases in product liability premiums in recent year were related to the number or size of product liability claims. The Interagency Task Force on Product Liability found that, "the absence of data * * * made it impossible to confirm whether insurer price increases in the area of product liability were justified." The Subcommittee on Capital Investment and Business Opportunities of the House Small Business Committee found that some insurers engaged in "panic pricing." A study by a special committee of the Illinois State Legislature confirmed this finding. That study observed that there has been an "exaggerated fear of the tort system." The Report also stated that:

Some increase in product liability insurance may have been justified. However, this is difficult to ascertain as few companies have any statistics that would justify the increases. Most product liability insurance premiums are judgment rated by the underwriter. The premium increases were not based on an actual historical or statistical data. See "Report and Recommendations, Judiciary I Subcommittee on Product Liability," Part I, Illinois House of Representatives, at p. 12 (1978).

Moreover, this Department and members of Congress have received hundreds of letters from small businesses indicating that they have received huge product liability premium increases although their claims experience was negligible or nonexistent. At present a substantial, albeit indeterminable, portion of product liability premiums are based on rates that have been developed on a purely subjective basis. Further, under current rating plans most small businesses do not benefit from having a good claims experience. All of this very strongly suggests that a mechanism is needed to help assure that product liability rates and premiums are closely related to actual product risk.

Very recent experience suggests that this need is even greater now that tort law reform is taking place at the state level. For example, the Illinois State legislature enacted a product liability tort reform measure. The most important part of this law reduces liability exposure for non-manufacturer product sellers. In spite of this fact, as the National Wholesalers-Distributors has indicated to your Committee, there has been no corresponding adjustment in the product liability premiums for the hundreds of non-manufacturer product sellers who are located in Illinois.

In order to assure that commercial insurers set product liability rates and premiums more accurately, and to assure that they will reflect any savings wrought by tort law reform, a number of states have passed product liability reporting laws. These laws require insurers to supply massive amounts of data; however, this process is unlikely to bring about immediate improvements in ratemaking procedures. We believe that a more effective approach is a thorough market solution. If product sellers are given the right to develop self-insurance cooperatives, commercial insurers will price their products as carefully as possible in order to maintain their market position.

As representatives of businesses with offshore captives have testified before the House Interstate and Foreign Commerce Committee, the presence of captives in the market causes product liability insurers to engage in true competition; they will bargain fully and fairly with product sellers in regard to product liability insurance rates and premiums.

In sum, we agree with you that it is important to take steps to stabilize the tort system. In point of fact, the constantly changing tort laws and rules have been part of the product liability problem.

However, we have grown to appreciate the fact that any tort reform effort will take a considerable period of time; legislative efforts toward this goal have brought about very strong controversy among product sellers, lawyers, consumers, labor and insurers. By way of contrast, the Risk Retention Act is supported by all groups except some segments of the insurance industry. The Act represents a significant initial step we can take to address the product liability problem and it is one that we can proceed with at this time.

We deeply value your interest in this topic and would be pleased to be of further assistance to you should you desire it.

Sincerely,

VICTOR E. SCHWARTZ,
Chairman, Task Force on Product Liability and Accident Compensation.

The CHAIRMAN. Senator Packwood.

Senator PACKWOOD. The bill has two purposes, the second of which you say permits product sellers to purchase product liability insurance on a group basis.

Now, distinguishing that from the self-insurance cooperatives, is it now impossible or illegal to purchase product liability insurance on a group basis?

Mr. MOYER. That varies from State to State. In some cases, it is contrary to law.

Senator PACKWOOD. Well, now, what happens on group health insurance where a company has a companywide contract and businesses in different States? How do they purchase group health and surmount that problem?

Mr. SCHWARTZ. There are fictitious group laws that apply only to property casualty lines, not health insurance.

Senator PACKWOOD. Please explain that.

Mr. SCHWARTZ. A total of 45 States have something called fictitious group laws. This means that a group of businesses that wish to get property or casualty insurance is not permitted to form a group and to then bargain with commercial insurers for a good rate.

The fictitious group laws do no apply in health fields.

We can supply the committee with——

Senator PACKWOOD. Wait. Run this by me again.

You know, Ford Motor Co. is not a fictitious entity. They operate in a variety of States and purchase companywide group health insurance. Explain to me why that is legal in different States, but they could not purchase product liability insurance?

Mr. SCHWARTZ. Well, they could. It's a single company. But if you have all three automobile manufacturers grouping together to bargain with a commercial insurer for property casualty coverage, product liability coverage, that would be illegal in 45 States.

Senator PACKWOOD. Why?

Mr. SCHWARTZ. These rules are very difficult to justify. Some say they encourage competition. I think you will find that a number of the witnesses from the insurance industry no longer agree that they are sound laws.

Senator PACKWOOD. Back up. You're missing the point of my question.

You mean to say the State laws prohibited—you cannot sell that kind of insurance in 45 States?

Mr. SCHWARTZ. You cannot form groups.

Senator PACKWOOD. I don't mean "form groups."

Mr. SCHWARTZ. It can be sold.

Mr. BARRETT. A company cannot sell to a group, provide a blanket policy to a group.

Senator PACKWOOD. When I used to bargain labor relations, one of the groups I bargained for was the Associated General Contractors. It was a Portland-Vancouver, Washington chapter, so we were bargaining on a two-State multiemployer contract. We would bargain for health insurance, a whole variety of employers, two States involved—apparently legal. This was 20 years ago.

You mean those same employers could not purchase product liability group insurance?

Mr. BARRETT. That's correct.

Senator PACKWOOD. Why?

Mr. BARRETT. Because of either fictitious group rulings or statutes in 40 or 45 States, they would be prohibited under those laws.

Senator PACKWOOD. You mean the laws would say that you are a fictitious group, you cannot—Jones Construction and Smith Construction can join together for the purposes of life or health insurance even on a multi-State group basis, but the law specifically says you cannot do it for product liability insurance?

Mr. BARRETT. For all property casualty insurance is my understanding.

Senator PACKWOOD. Let me put it the other way around then so I make sure I understand.

Are you prohibited from purchasing any group insurance unless permitted by State law? Or is it the other way around, that you can purchase any kind of group insurance you want, even if you're multiemployer, unless precluded by State law?

Mr. BARRETT. As I understand it, you are prohibited from purchasing property casualty insurance of any type, which would include automobile, other types of insurance, on this group basis.

Senator PACKWOOD. Let me ask my question again.

Now, listen carefully. If you are a multiemployer group, are you prohibited from purchasing any group insurance of any kind unless allowed by State law? Or is it the other way around, you can purchase any kind of group insurance you want unless prohibited by State law?

Mr. BARRETT. I don't know the answer to that, sir.

Senator PACKWOOD. Does any of the panel know the answer?

Mr. SCHWARTZ. I think it is the second example. We will research that and provide the answer to the committee. I think it's the second one.

Senator PACKWOOD. So you think the answer is you can be a multiemployer, multi-state unit and purchase any kind of group insurance unless State law says you cannot purchase and then they list the kind of group insurance you cannot purchase?

Mr. SCHWARTZ. I think that's the way the regulations are set up.

Senator PACKWOOD. Thank you.

No other questions.

The CHAIRMAN. Thank you very much, gentlemen.

[The following information was subsequently received for the record:]

U.S. DEPARTMENT OF COMMERCE,
OFFICE OF THE SECRETARY,
Washington, D.C., April 23, 1980.

Hon. BOB PACKWOOD,
U.S. Senate,
Washington, D.C.

DEAR SENATOR PACKWOOD: We deeply value your interest in the Risk Retention Act and how it would affect existing state regulation of insurance. As we indicated to you at yesterday's hearings on the Act, we would provide you with more specific information as to whether fictitious groups laws prevent the sale of group insurance unless otherwise permitted, or whether they prohibit specific types of group sales.

As we tentatively indicated to you at the hearing, fictitious group provisions generally prohibited group sales of only certain types of insurance. For example, the Oregon fictitious group law, which is typical, prohibits the sale of:

"* * * property, inland marine, casualty or surety insurance, or any combination thereof, at a preferred rate or premium to any person based upon a fictitious grouping of that person." (Oreg. Rev. Stat., sec. 737.346(2)(a))

"Fictitious grouping" is defined to mean "a grouping by way of membership, license, franchise, contract, agreement or any other method other than common ownership, or use and control." (Oreg. Rev. Stat. sec. 737.346(1))

However, the Oregon law is also typical in that it clarifies the prohibition:

"Nothing in this section applies to polices of life or health insurance or insurance for public bodies * * *." (Oreg. Rev. Stat. sec. 737.346(3))

Fictitious group prohibitions for property and casualty insurance are present in 46 jurisdictions, and when provided by statute, are generally in a form similar to that of Oregon. In 24 states, these prohibitions are expressly provided by statue, in 8 states by administrative ruling or order, and in 13 states (plus the District of Columbia) by insurance department interpretation of unfair rate discrimination statues. For your information, we have attached copies of laws and administrative determinations prohibiting fictitious groups for several states illustrating the various treatments that are provided.

Also, this will confirm our testimony that group property and casualty insurance would be unavailable to a multistate association, such as an employers' group, so long as one of the states involved has a fictitious group prohibition.

As we inidicated, Title II of the Risk Retention Act would remove the prohibitions on fictitious groups only for the purchase of product liability and completed operations insurance. This would enable product sellers to join together to purchase this insurance on a collective basis—which generally they are unable to do at present.

Again, we appreciate your interest in the effect of the Act and would be pleased to be of further assistance to you in regard to that legislation.

Sincerely,

VICTOR E. SCHWARTZ,
Chairman, Task Force on Product Liability and Accident Compensation.

The **CHAIRMAN.** We will next hear from Congressman John LaFalce from New York, who will make a brief statement.

We will include your statement in the record, Congressman. You may summarize your statement if you wish.

You can go right ahead. We're kind of pressed for time, so just go right ahead.

STATEMENT OF HON. JOHN J. LaFALCE, U.S. REPRESENTATIVE FROM THE THIRTY-SIXTH DISTRICT OF NEW YORK

Mr. **LAFALCE.** Thank you very much, Mr. Chairman.

I appreciate the opportunity to appear before you today on bills presently pending before your committee.

Since my prepared remarks are going to be introduced into the body of the record, I will just tell you how I became involved in this subject.

In January of 1977, I was elected chairman of a small business subcommittee on the Small Business Committee. And because of the tremendous number of complaints I was receiving from my small business constituency and also because of the discussions that were taking place before the House and amongst Congressmen about the problems they were hearing from their business constituency on the issue of product liability insurance, I thought I would embark on a series of hearings to see what I could learn about the problem.

And I must have had close to 20 days of hearings from that time to the present, Mr. Chairman. I have learned a lot and have also come to certain conclusions.

Now, let me just share some of the things that I learned with you, some of the findings, and then let me also go into some of my conclusions as they relate to the bills before you.

I found out that the state of knowledge within the insurance industry and the state of knowledge within the business community regarding the rates that were being charged for product liability insurance were embarrassing.

As a matter of fact, witness after witness from the insurance industry testified that they themselves were embarrassed by the paucity of data that they were using to determine their rates.

Well, to make a long story short, we learned, as of the time of our hearings, circa 1977-78, that of the total product liability insurance premium dollar in the United States of America, at that time less than 10 percent of that product liability dollar was derived from the manual of rates that is produced by the insurance industry, in particular ISO, the Insurance Services Office.

That means that as of the time of the so-called product liability crisis—and this was usually spoken of in the years 1976, 1977, beginning of 1978, et cetera—over 90 percent of the product liability insurance premium dollar was being based on something other han the manual of rates, in large part on the subjective judgment of the individual insurance underwriters.

Now, that situation has changed. Today it is no longer 10 percent based upon the manual; 90 percent, in large part on the subjective udgment. It shifted to 20-80.

So, about 20 percent is based on the manual, and 80 percent, in arge part, on the subjective judgment of the individual insurance nderwriter.

Now, that's very, very interesting and meaningful, because whenever we are involved in subjective judgments, as opposed to bjective judgments, we have to look at what goes into the formation of the subjective judgment.

If it is reality, then the relationship between the subjective judgment and a proper judgment might be one in the same. It's easier o make.

But if the factors that are being used in making one's subjective idgment are not based upon reality, but on an erroneous percepon of reality, then there is great cause to believe that the subjecve judgment might be in grievous error.

And I found, Mr. Chairman, that there was a marked difference etween reality and the perception of reality on those factors most kely to be considered by insurance underwriters in forming their idgment on the premiums that would be charged.

And again, these account for from—depending on how you're oking at it—in excess of 80 to 90 percent of the total liability surance premium dollar.

Witness after witness testified from the business community that iere was no relationship between their experience and the rates iat were being charged them. In great part, that was true and ill today is true, because the premiums are basically based on the bjective judgment of the underwriter.

What were some of the perceptions that were prevalent at the me that we saw such precipitous increases in premiums?

First, we have to look to the number of claims, as has been stated by Professor Schwartz, who did an outstanding study, from 1976 to the present, of this whole issue. The material that was disseminated both by business groups and by insurance industry groups and insurance companies, individually, referred to the fact that there had been a virtual explosion in the number of claims.

Whereas, before there were a relatively small number of claims, now there were approximately 1 million claims being brought per year.

And testimony was received before my subcommittee that there were 1 million claims being brought per year, that this was a precipitous increase that helped justify the precipitous increase in rates. Advertisements were run by insurance companies that there were 1 million claims per year. The materials distributed to insurance underwriters claimed that there were 1 million claims per year.

The reality, Mr. Chairman, is that there were not, and are not, 1 million claims per year, according to the information produced before my subcommittee.

There is a range of from 60,000 to 140,000 claims being brought per year. Thus, the perception of reality that existed uniformly, virtually universally, was overstated by approximately 800 percent. I think this is very relevant, because it was one of the greatest factors considered by the insurance industry in determining what the rates should be.

Another factor, Mr. Chairman, is the fairness or the unfairness of the law. Now, I, for one, believe that there should be greater uniformity in the area of product liability law. I think that there should be greater clarity, less ambiguity, and that this would help considerably.

I do not, for one, believe that we are going to achieve this greater clarity and uniformity by permitting the States to adopt changes in their laws on an ad hoc basis.

And so I would concur with, I believe, the sentiments expressed by Senator Stevenson, that we should consider Federal legislation in this area.

However, we would differ markedly in what we think the results of that would be and perhaps differ markedly in the substance of the changes that should be enacted.

The insurance industry testified that even if the laws that they were advocating were adopted—and these would be the most Draconian laws that you could think of, prohibiting in great part injured persons from seeking redress in the courts or greatly limiting their capacity under present law to obtain fair compensation—still there would not be any significant impact on the product liability premium dollar.

Further, when one studies the fairness or unfairness of the law—and this is a very difficult thing to do—the only comprehensive attempt that has been made to study what happens when a claim is brought, to the time of settlement or jury verdict, has been made by the insurance industry in what is known as a closed claim study.

And they concluded, based upon the results of their study, that in those instances when the law is applied to the facts—in those instances when the law is tested, when a jury must render a verdict, in three out of four instances a jury has returned a verdict of no cause of action.

In other words, in three out of four instances when the jury has had to apply the law to the facts, the jury has said, "Based upon the existing law, you, the injured party, shall receive nothing."

I could go on and on, and cite other instances—of the infamous lawn mower case——

The CHAIRMAN. Our time is relatively short.

If you can wind up shortly that would be helpful.

Mr. LAFALCE. Well, let just say, Mr. Chairman, that after I have spent years on this subject, if we are going to improve the situation at all, we have got to go to the insurance ratemaking mechanism. If we can't do that on a Federal level, the very least we could do—and this would not be a total solution to the problem, but it would be a temporary means of helping to address it—is to provide some modicum of self-insurance, some modicum of competition.

The Product Liability Risk Retention Act is a modest—very modest step in that direction. It has the support of virtually every single group that has addressed itself to studying this issue, whether consumers, whether labor, whether the business community.

The only group, to my knowledge, which has any opposition to this is the insurance industry itself. And, of course, I would understand that, because for the first time it would provide an alternative to going to the insurance industry, an alternative that I think is tremendously needed because of the atrocious ratemaking practices that have existed, at least with respect to product liability in the past, and which show no signs of significant improvement.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Congressman.

[The statement follows:]

STATEMENT OF HON. JOHN J. LAFALCE, U.S. REPRESENTATIVE FROM NEW YORK

Mr. Chairman and Members of the Committee, I am pleased to appear before you to testify in support of two legislative proposals concerning product liability insurance now pending before your Committee: S. 1789 and H.R. 6152.

I first became aware of the problems of product liability insurance during the fall of 1976 when I started receiving complaints concerning the unbelievably high premium increases from small businessmen within my congressional district in western New York In February of 1977, I was elected Chairman of a Small Business Subcommittee, and in that capacity, started receiving complaints from across the country. I felt that I would embark on a series of hearings regarding the impact that product liability insurance was having generally, and especially on the small businessman. I did so, and to make a long story short, we wound up having 16 days of hearings with six volumes of testimony.

Our subcommittee's report to Congress found two principal causes of the product liability "crisis"—deficiencies in the product liability rate-making mechanisms and uncertainty in the tort-litigation system. While I have introduced in Congress a variety of measures addressed to these primary causes, even if these were adopted today, product liability rates will not be impacted until many years hence.

Thus, it was felt that there was the need to impact the problem of excessively high rates in the short-term—an objective the Risk Retention Act is designed to accomplish. It must be emphasized, however, that the Risk Retention Act, does not strike at the root causes: Remedies addressed to the two aforestated principal causes must be adopted if we are to truly solve the product liability problem.

The stated purposes of the Risk Retention Act, which evolved under the tulelage of several House Subcommittees, are to reduce product liability insurance costs, to insure the prompt payment of legally valid claims, to promote competition among providers of product liability coverage, and to reduce the outflow of capital to offshore captive insurance companies. One additional feature of the act is tha has the effect of preempting state laws which prohibit selling product liabi insurance to "fictitious groups"; this would thus facilitate the ability of group manufacturers to obtain product liability insurance in the commercial marketpl

In addition to my Subcommittee's extensive hearings, the Subcommittee on C sumer Protection and Finance of the House Committee on Interstate and Fore Commerce also held nine days of hearings on the Risk Retention Act. Testim was recieved from over 40 witnesses, including myself and many of my Colleag and representatives from businesses trade associations, consumer groups, t lawyer associations and the insuance industry.

This proposal would permit the Department of Commerce to license "risk ret tion groups." These groups would be organized by businesses for the purpose insuring themselves against product liability claims. The amount of premiu charged would ultimately reflect the experience of a particular group. Thus, ther a direct incentive for all participants in a group to adopt appropriate loss prev tion techniques. Moreover, it is contemplated that premiums paid to the groups be taxed in a manner similar to insurance companies.

The proposal has the support of virtually all business groups who have conside it, including the National Association of Manufacturers, the National Machine T Builders Association, the National Federation of Independent Businesses, the Sp ing Goods Manufacturers Association, the Scientific Apparatus-Makers Associat and the National Association of Wholesaler Distributors. It also has the support the Consumer's Union, the National Consumers League and Congress Watch. fact, the only interest group which I am aware of which opposes this measure is property-casualty insurance industry.

Considering one of the purposes of the bill—the promotion of competition am providers of product liability coverage—this opposition is not surprising. Pres ably, as a result of this measure, many manufacturers will be able to obtain prod liability coverage at a cost substantially less than is presently available to th

Mr. Chairman, during this period of double-digit inflation, I believe that Congress has a duty to consider and then support any bill which would lower c for this country's businesses. The Risk Retention Act would provide particular re for small business, which is currently threatened by a wave of bankruptcies beca of double-digit inflation and the Administration's anti-inflation policies.

I am extremely pleased that the Carter administration has seen fit to endorse Risk Retention Act, that the House Commerce Committee has taken expediti action, and that the House passed the bill by a resounding 332-17 margin. Howe I would note that it was neither the first choice of my small business subcommit nor of the Department of Commerce's task Force on Product Liability, in respective quests for a remedy which would ease the product liability affordabili availability problems in the short term.

Initially, both my Subcommittee and the Task Force recommended permitt businesses to obtain tax deductions of amounts set aside in trust, the purpose which was to pay product liability claims and expenses. The effect of such tr would enable businesses to provide "self-insurance" for their potential prod liability exposure with pre-tax dollars.

During the 95th Congress, the so-called product liability trust concept had con erable support of the House membership. Over 120 different members were spon of one or more of the several trust proposals introduced. In fact, former Represen tive Joe Waggoner, then Chairman of the Miscellaneous Revenues Subcommitte the Ways and Means Committee convened two days of hearings on the approa

Unfortunately, the Department of Treasury was vigorous in its opposition— opposition which I believe was unwarranted. Treasury was of the opinion that trust concept embodies an unacceptable form of subsidy, and as a result, Administration rejected it as an inappropriate remedy.

Thus, Mr. Chairman, while it was not my first choice to correct the m problems in this field, I am pleased that the House overwhelmingly approved Risk Retention Act and that the Senate Committee on Commerce, Science Transportation is holding a hearing on Risk Retention Act. I applaud the Sena from Nevada for convening this important and necessary hearing.

The CHAIRMAN. Next we will hear from James H. Mack, pub affairs director of National Machine Tool Builders, and Mr. Le R. Marchese, legal counsel, National Association of Wholesale D tributors.

STATEMENTS OF JAMES H. MACK, PUBLIC AFFAIRS DIRECTOR, NATIONAL MACHINE TOOL BUILDERS, McLEAN, VA.; AND LOUIS R. MACHESE, LEGAL COUNSEL, NATIONAL ASSOCIATION OF WHOLESALE DISTRIBUTORS, WASHINGTON, D.C.

Mr. MACK. Good morning, Mr. Chairman. My name is Jim Mack. I'm public affairs director of the National Machine Tool Builders Association. We welcome the opportunity to visit with you this morning in support of S. 1789, an extremely important product liability remedy.

The results of our most recent product liabilities survey reveal the magnitude of the products liability crisis within the machine tools industry.

Our full statement contains a detailed analysis of the 1980 survey statistics. However, a brief summary of the data reveal that a little over half of our members still have no primary coverage or have substantial deductibles under their 1980 policies.

Thus, insurance company assertions that the crisis is easing seem unsubstantiated by the facts. Furthermore, insurance industry spokesmen have predicted underwriting losses in the early to mid-eighties.

This cyclical downturn, together with recent compensation trends in the tort litigation law, is likely to produce a hardening of insurance markets and higher premium costs in the absence of remedial legislation.

The Commerce Department, in its exhaustive 2-year study of the product liability mess, found that the problem is caused by both uncertainties in the tort system and by ratemaking difficulties.

S. 1789 deals with this second cause. The House Commerce Committee begins hearings tomorrow on tort legislation, which we also support. We are hopeful that the House will proceed with tort legislation with some dispatch, and that you will have this legislation before you later this year or perhaps next year.

But that should not impede your action in dealing now with this important first step to solving the product liability problem.

As you know, legislation almost identical to S. 1789 was overwhelmingly passed by the House last month. We believe that the magnitude of this approval by a margin of 332 to 17, and the broad philosophical spectrum of its support reflect the equity of using a market mechanism to balance important interests in the area of product liability insurance coverage.

Nevertheless, we appreciate that there remain a few who continue to maintain some reservations about the appropriateness and effectiveness of the approach of S. 1789. It is to these reservations that we will address the balance of our comments today in the hope of allaying what we believe to be unfounded fears and inaccurate criticism of what 1789 seeks to accomplish.

One of the principal objections, and what apparently is the essential concern of some insurance groups, is that this legislation constitutes what they believe to be a dangerous and unwarranted precedent for Federal regulation of the insurance industry.

To meet this concern, we begin by pointing out that, although the Risk Retention Act would preempt some existing State law by establishing a Federal mechanism whereby groups of manufacturers and product sellers could pool all—or most likely part—of their product's liability risk exposure, it in no way amends the existi McCarren-Ferguson Act itself.

Although we recognize that the regulation of insurance has tr ditionally been a matter generally left to the discretion of t individual States, we are compelled to point out that even priva insurers themselves take into account the interstate complexion products liability and set rates on a national, not a State-by-Sta basis.

What this bill proposes and what we strongly support is t rational recognition and treatment of a national problem with national solution.

Insurance industry opponents have also criticized this act unnecessarily duplicating risk-financing options presently availal to businesses at the State level. Specifically, these critics point the Colorado Captive Insurance Company Act of 1972, which th emphasize was designed to encourage the domestic formation group captive insurance companies. However, the only other Stat which have adopted a similar statute are Tennessee, which in 19 enacted the Malpractice Insurance Captive Insurance Compani Act, and Virginia, which enacted a Captive Law this year. T Virginia law is more restrictive than the other two.

However, the Colorado law itself contains regulatory standar which make it difficult for trade associations or small busine groups to utilize it.

For example, a Colorado trade association captive must ha annual premiums of over $1 million, and it is subject to approval its rates.

Also, the law requires that an applicant for a captive show th insurance coverage was otherwise unaffordable or unavailab This, of course, restricts the use of captives to situations involvi severe availability or affordability problems. Price competition not a sufficient justification.

Reciprocals and other suggested mechanisms are effectively pr vented by some State law regulations and waiting periods fro operating in several States and providing extensive loss preventi and other necessary services for product liability, risk retenti pool.

Thus, the real issue, Mr. Chairman, involved in passage of 1789 is not whether risk retention groups should be formed at t State level, or under the aegis of the Commerce Departmen rather, it's whether risk retention groups are to be formed in t United States pursuant to provisions of this legislation, or wheth they will continue to be forced offshore to Bermuda or the Gra Cayman Islands or other exotic spots, with the resultant outflow capital from our own country. To tell our members and others th the best solution to their product liability insurance problem is send their capital offshore seems to us to be an abrogation responsibility by our Government.

The risk retention groups which S. 1789 would authorize wou not be in the general insurance business, and therefore, logical should not be subject to all of the many regulations imposed upo regular commercial insurers.

Thus, S. 1789 must be viewed as a form of regulatory reform, in that its net effect is to reduce regulation, even though the regulatory authority would be transferred to a Federal agency.

However, S. 1789 does subject approved groups to very stringent antitrust and other requirements where such regulation is appropriate.

For example, risk retention groups would be required to maintain proper reserves. And it should be noted that risk retention groups would also be subject to applicable State premium taxes.

Alternative insurance vehicles which would be created by virtue of the Risk Retention Act in no way serve to put commercial insurers at a disadvantage. Moreover, this proposal provides competitive incentives which can only benefit all consumers. To oppose this market solution to the product liability mess on the incredible theory that it is somehow antifree enterprise seems to us to be the height of irresponsibility.

The existence of this system will serve as a brake on future inequities in insurance underwriting practices. It will assure that the enactment of tort law changes will be reflected in lower premium costs. In a very broad sense, S. 1789 is a consumer protection act.

We support the very helpful changes which the House Commerce Committee made in the original Commerce Department Act embodied in S. 1789. These changes include the removal of some of the broader powers conferred upon the Secretary of Commerce; removal of language making a risk-retention group a fiduciary for prospective claimants; and inclusion of a sunset provision assuring that the law will not be abused by overzealous bureaucrats in the event that it is not used by American industry.

We commend these helpful changes to your attention and we urge their adoption by the Senate.

Frankly, Mr. Chairman, we fail to understand the intensity with which some insurance groups have approached this legislation. Frankly, the opposition of most insurance carriers and their trade associations comes, we feel, with ill grace. They testify in Washington that there is no problem; yet, in the various State legislatures, they sound the alarm of a products liability crisis. They refuse to provide coverage that over half of our members can afford, and in the next breath, they tell our members that they don't want them to help ourselves.

We see this conduct as very shortsighted, indeed. S. 1789 is a very narrow, modest approach to address a very narrow, albeit serious, product.

Others have come forward with much more extreme and wide-ranging proposals which the manufacturing and distributing community have generally not supported in the past.

But, Mr. Chairman, our members' backs are against the wall and if a consensus cannot be achieved on this very modest approach, perhaps other alternatives should be explored by the Congress.

In conclusion, Mr. Chairman, we urge your committee to carefully consider and recommend adoption of S. 1789 as quickly as possible. This course of action will enable our members and other product sellers, many of whom are small businesses, to protect them-

selves while Congress and State legislatures are wrestling w
longer range solutions to the product liability mess.

Again, thank you for this opportunity to testify before you t
morning. We will be pleased to respond to any questions you mi
have.

The CHAIRMAN. Thank you very much, Mr. Mack. Mr. Marche

Mr. MARCHESE. Thank you very much, Mr. Chairman. My na
is Louis Marchese. I am associate general counsel of the Natio
Association of Wholesale-Distributors.

The association is a federation of some 114 national commod
associations, which, in turn, are composed of approximately 45,
wholesaler-distributors throughout the country.

Generally, these wholesaler-distributors are small businesses a
the product they sell passes through their warehouse in its origi
form; generally without the package being opened.

With your permission, I will summarize my remarks and requ
that the full written statement be included in the record.

The CHAIRMAN. It will become part of the record.

Mr. MARCHESE. Thank you very much, Mr. Chairman.

The wholesale distribution industry needs the Risk Retenti
Act. Product liability has become a very serious problem to t
wholesale distributor because of the adoption of the doctrine
strict liability and tort in some 42 States throughout the count

That doctrine makes sellers of a product, not necessarily t
manufacturers, but all sellers of the product, liable, regardless
fault. Generally speaking, wholesale distributors have no cont
over the design and construction of the product. The adoption
this doctrine has made it important to wholesaler-distributors th
protection against loss from product liability available to the

To the wholesaler-distributor today, there's a very serious ava
ability problem. The insurance industry says that availability
not a problem. Unfortunately, I think their concept of availabil
is their willingness to offer insurance at any price. Availability
any price translates into nonaffordability to the wholesale distri
tor, which means that there is a lack of practical availability to t
wholesaler-distributor.

Now the wholesaler-distributor has some options. He can go ba
but we don't feel that to be a viable option. He generally cann
self-insure because he's not big enough to go it alone in self-ins
ance. He doesn't have the sufficient resources to do so. He need
feasible alternative.

We recognize that tort reform is essential. We recognize that t
laws of various States need to be changed. NAW has been activ
engaged in working for tort reform at the State and Federal lev

We feel that some very strong progress has been made, but t
reaction of the insurance industry to this tort reform has been
wait and see what develops.

I submit to you, Mr. Chairman, that the wholesaler-distribut
cannot afford to wait and see. Some 23 State legislatures ha
already passed tort reform legislation and in 9 of those States, t
particular plight of the wholesaler-distributor has been recogniz

These States have a law which we call a seller's provision law
the books which limits very substantially the liability of wholes
er-distributors and all other non manufacturing sellers.

In all of those States, the insurance industry has failed to come up with any meaningful rate reductions, despite this very substantial reduction of risk caused by the adoption of the seller's provision in these States.

In Kentucky, the ISO office in that State reviewed that law. They recognize the risk has been reduced, but their advice was to wait and see with respect to any rate reduction.

In Illinois, at the request of the wholesaler-distributors of that State, the ISO office again looked at the law and their advice was to wait and see what develops. The same story is true in all of the other States.

Mr. Chairman, it is not now, nor has it ever been, the objective of the National Association of Wholesaler Distributors tort reform legislative effort that the insurance industry be the sole beneficiary of tort reform.

We feel it is their customers who should benefit and through them, the consumers who bear the ultimate cost.

Yet, the biggest reaction of the insurance industry has been to oppose risk retention, which we feel provides a very feasible alternative to this very interim problem of the wholesaler-distributor.

It's very difficult for us to understand this opposition to risk retention, on the one hand, and the support of the insurance industry for tort reform on the other hand.

For the wholesaler-distributor to adopt a wait and see posture is to invite disaster. The wholesaler-distributor must be able to live in a competitive environment. In order to do so, he needs the means of obtaining product liability loss protection, and he needs it now because he's having a very difficult time finding it at competitive rates.

We feel very strongly that risk retention would permit the wholesaler-distributor and other small businesses in similar situations to be able to develop and find that insurance at affordable rates.

Therefore, we support risk retention and we urge its adoption now.

Thank you very much, Mr. Chairman.

[The statement follows:]

Statement of Louis R. Marchese, Associate General Counsel, National Association of Wholesaler-Distributors

I am Louis R. Marchese, Associate General Counsel of the National Association of Wholesaler-Distributors (NAW).

NAW is a federation of 114 national commodity line associations which in turn are composed of over 45,000 merchant wholesaler-distributors located throughout the 50 states.

A full listing of the associations affiliated with NAW is contained in Appendix I. The product liability crisis is of major concern to almost all of the commodity lines represented. We thus sincerely appreciate the Commerce Committee's moving to begin its work on the Risk Retention Act so promptly following its 332–17 endorsement by the House last month, and this opportunity to discuss with you why immediate Senate action on S. 1789 is imperative.

THE WHOLESALE DISTRIBUTION INDUSTRY

Wholesale distribution is a major segment of the United States economy, with sales forecast by the U.S. Department of Commerce to reach just short of $1 trillion this year. The industry provides exployment to over 4.2 million individuals. Our membership accounts for approximately 60 percent of industry sales, and employment.

NAW members distribute virtually every conceivable type of consumer and industrial product. They purchase goods from manufacturers and resell them to retailers and to industrial, institutional, commercial and other types of business users, as well as to government.

The majority of this merchandise passes through the wholesaler-distributor's warehouse to the customer in its original form, without the package being opened. A smaller proportion of the merchandise which our members distribute is assembled before shipment, or modified to customer specifications. Wholesaler-distributors in certain commodity lines also perform installation and/or subsequent servicing activities. A significant portion of the merchandise which our members sell is direct-shipped from the manufacturer to the customer without ever passing through the distributor's warehouse.

Despite the impressive aggregate statistics cited above, the wholesale distribution industry is preponderantly composed of small-to-medium-sized businesses. The average NAW member's sales volume is less than $5,000,000; he has less than 50 employees. It is through this size of business that the vast bulk of products move to market in our economy.

THE PRODUCT LIABILITY SITUATION IN OUR INDUSTRY

Insurance against product liability loss has become a major part of the total insurance cost of the wholesaler-distributor over the past 5 years, as rates have skyrocketed.

Net-profits-before-taxes in our industry range from a low of one-half of one percent of sales to a high of 4 percent, with an average of about 1.7 percent. Thus, it can readily be seen that if the cost of product liability insurance protection is as high as one percent of sales, the impact on profits and financial stability is most significant.

These premium increases are, objectively, attributable in part to the evolution of tort law from a fault-based to an entitlement-based system, as a result of the adoption by the courts of the doctrine of strict liability in tort. But, clear and compelling evidence exists that the commercial underwriters are mis-pricing product liability insurance for wholesaler-distributors, and have been unresponsive to changes in the tort system which reduce wholesaler-distributor risk which have been enacted in some twenty states over the past three years.

WHY THE RISK RETENTION ACT IS NEEDED

The provisions of the Risk Retention Act are the result of very exensive studies of the product liability problem and how insurance for product liability is rated by the Task Force on Product liability and Accident Compensation of the Department of Commerce. The legislation recognizes that new institutional entities are necessary to provide practical availability of product liability insurance protection for those who have experienced difficulty in obtaining this insurance at affordable rates, by making the product liability market more competitive, and thus more responsive to and reflective of, true risk than is presently the case.

The insurance community opposes the Risk Retention Act. They assert that product liability insurance is readily available. They avoid the issue of affordability. If availability means the willingness of insurance companies to offer coverage at any price, then it can be said that there is no availability problem. But, to the small and medium-sized business, coverage at any price often means non-availability. When the cost of insurance coverage is prohibitive, an availability problem obviously exists.

Affordability in this context may be defined as the ability of a firm to absorb and/or pass its product liability insurance costs on to customers within the life of the insurance policy. Larger firms may spread the additional costs across a larger number of units and/or absorb these costs for some period of time. Smaller firms such as wholesaler-distributors find it more difficult to pass these additional costs on to customers and remain competitive. As that difficulty increases, the affordability of product liability coverage is substantially lessened and as a consequence, the availability as a practical matter is reduced. This squeeze effect on wholesaler-distributors and other smaller businesses often forces a decision that the protection needed must be dropped in order to remain in business. The company goes "bare," unless a feasible alternative is available.

Going "bare" is obviously no solution at all. It seriously impairs the protection which adequate insurance affords the consumer and places the small business in an untenable position, long-term. Thus, the only true alternative to the affordability problem now faced by our members is an opportunity to participate in a form of risk retention that will more closely align their particular mode of operation to the cost of protection.

This is particularly important to the wholesaler-distributor, who, because of the vagaries of the insurance rating system and the lack of competition in products liability underwriting, has paid an unjustified, excessively high cost for product liability insurance during the last five years.

Many insurance companies look to the ISO Casualty Rate Manual as the primary source of premium rate factors to be applied to specific risks. In the absence of hard data, the rate factors developed for product liability insurance, particularly for wholesaler-distributors, have been subjectively determined. For many wholesaler-distributors there is no specific rate classification. Instead, underwriters use the classification which best approximates the loss exposure as perceived by the underwriter. A common approach is to use a percentage of the manufacturer's rate for a particular product category.

Since Wholesaler-Distributors represent hundreds and in some cases thousands of manufacturers, this practice is, at best, an imperfect mathematical science. At worst, wholesaler-distributors suffer a chaotic insurance rate-making process as a result.

Tremendous variations in rates, objectively inexplicable, among wholesaler-distributors of identical size, product mix, and product liability history appear in product liability insurance surveys which we have conducted among our members. Multiples of a factor of 10X are common. This is to say, that essentially identical companies are faced with premiums which differ by as much as 1,000 percent, without any logical, understandable explanation.

The collective response of the insurance industry to the product liability legal environment has been severe rate increases, restrictive policy wording and reduction of policy coverage. Insurance industry spokesmen have stated that insurers merely respond to the legal system as they find it and that insurance costs are determined by that system. The evidence is that they respond readily to increasing risks by raising premiums, but do not so respond when risk is decreased.

Insurance industry response to tort reform legislation enacted in some twenty states over the past three years, and the continuing, obvious, imperfection of the rating structure, despite the recent severity of the product liability situation, leads to the strong conviction that a major cause of the problem is the perception of the insurance industry that it can function as a monopolistic supplier. Commercial underwriters are today the only real domestic source of product liability insurance. The Risk Retention Act will open product liability insurance underwriting to competitive options. If, as the commercial underwriters allege, the Risk Retention Act is unneccessary. . . . if as they allege, their product liability coverage is competitively priced, they have nothing to fear from its enactment.

THE RELATIONSHIP OF TORT LAW TO INSURANCE RISKS

From the very beginning of the product liability crisis, NAW has recognized the fundamental need to reform tort law as it pertains to product liability. In pursuit of this goal, NAW has developed specific courses of action which will result in substantive product liability reform, and has initiated the steps required to bring about its implementation. The Association is working on two simultaneous fronts—Federal and State. At the state level, NAW members in 33 states have joined together in product liability task forces to work for tort reform legislation in these states. As I have noted, twenty-three of these states have responded by enacting some form of reform legislation. While far from comprehensive enough to permit an abrupt reversal in the spiral of increasing claims, awards and rising insurance premiums, these reductions in risk nevertheless should have resulted in a modification of premiums to reflect lower true risk. This has not been the case.

This point is particularly significant with respect to wholesaler-distributors and other non-manufacturing sellers. Adoption of the strict liability in tort doctrine by the courts of some forty states over the past seventeen years brought all sellers, manufacturers and non-manufacturers alike, into the litigation process, regardless of fault. By encompassing wholesaler-distributors, who generally are not in a situation where they have either the ability or the opportunity to discover or correct defects in a product, strict liability in tort resulted in substantial new exposure for wholesaler-distributors and, thus for their insurance carriers. Premium increases of significant magnitude were the result.

Legislatures in nine of the twenty-three states which have passed product liability reform legislation in the past three years have responded to this inequitable situation by enacting laws eliminating the application of the strict liability in tort doctrine to wholesaler-distributors and other non-manufacturing sellers, by making such sellers responsible only for their own negligent acts. Significant reduction of risk and elimination of non-manufacturing sellers at the threshold of the litigation process, and thus reduction of the cost of defense to insurance carriers is the result. Logically, one would expect that in the face of the substantially reduced exposure of wholesaler-distributors which is brought about by a seller's exclusion provision, there would be a corresponding reduction in the product liability insurance premiums of firms in the nine states which have enacted this legislation. That is, if the carriers price product liability insurance based on the true risk assumed.

This has not happened except in isolated instances, for wholesaler-distributors in those states with such seller's exclusions. Instead, the insurance industry has refused to adjust its premium structure, with rare exception. Let me cite two examples:

1. In Illinois, where the legislature passed a law in 1979 eliminating the application of the doctrine of strict liability to non-manufacturing sellers, except in certain very limited instances, the reaction of the insurance industry has been to "wait and see" what develops.

The Insurance Services Office in Illinois has strongly advised against any premium reductions. Their refusal to respond is pointedly demonstrated in Appendix III, Exhibit A.[1]

2. In Kentucky, a state that has also passed a bill precluding application of the doctrine of strict liability in tort to non-manufacturing sellers, the Insurance Services Office in that state, while admitting the law could be a justification for rate reduction, concludes that it is better to wait and study claims experience before considering such reductions. See Appendix III, Exhibit B.

In Arizona, Colorado, Georgia, Nebraska, North Carolina, South Dakota, and Tennessee, all of which have similar statutes, I can tell you the situation is no different. The insurance industry has been unresponsive.

Wholesaler-distributors and others in the business community cannot afford the luxury of accepting the "wait and see" attitude of the underwriters which they are financing through unnecessarily high premiums. Nor, in equity, should they, if alternative options can be made available. The Risk Retention Act is such an alternative, and a very skillfully crafted one at that, because it brings about a set of conditions where product liability insurance cost will be determined in a more competitive environment and will thus be based on a truer assessment of risk than is the case today.

By facilitating options to the present product liability underwriting system, the Risk Retention Act will significantly enhance competition in the product liability insurance market, reduce the practical unavailability problem now facing small business, and generate a premium structure which more accurately reflects the true product liability risks of wholesaler-distributors. If this legislation is enacted, we expect the cost of product liability insurance for our members to decrease significantly.

Comments on insurance industry position

Insurance industry representatives will no doubt repeat their arguments to this Committee that no product liability insurance problem really exists today. This is not correct.

They will point to the need for tort reform. We agree, as stated at the outset. But, as we have documented, tort reform, in some cases of significant scope, has occurred; without insurance industry response. It was, and, is not the objective of our association's tort reform effort for the insurance industry to be the beneficiary of these modifications of state law. It is their customers who should benefit, and thru them, consumers who bear the ultimate cost.

They will assert that product liability insurance premium increases are not occurring. They will neglect, I suspect, to mention the significant increase in deductibles which we are seeing as new policy quotations are being made. Less coverage for the same premium is an increase in the cost of that coverage.

They will explain that present law allows the formation of domestic captives. As the Commerce Department's Task Force on Product Liability and Accident Compensation has documented, and as we can tell you from our own experience, this is not, as a practical matter, a viable reality.

They will begrudgingly suggest the availability of Bermuda-based captives as a solution. True enough . . . but why should we export American capital? What's wrong with the United States?

They are likely to give the impression that insurance industry opposition is uniform. It is not, as evidenced by the letter in Appendix IV from the Chairman and President of the Continental Corporation, one of the largest underwriters of product liability insurance in the nation, to our Association's Executive Vice President, expressing unequivocal support for the Risk Retention Act.

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[1] The appendices are in the committee files.

Finally, they may well omit reference to the availability/affordability climate which will prevail 6–18 months from now. Our insurance advisors agree with other informed observers of product liability trends that serious affordability/availability problems lie ahead, which will approach, and possibly exceed, those of the 1975–78 period.

Action needed now

The facts establish the need for a domestically available, alternative means to obtain product liability coverage for small business. The Risk Retention Act provides this means. It has met the test of public scrutiny with great support the result . . . with the singular exception of the insurance community, which opposes the measure, in truth, in our view, because they would simply rather not compete. It is good legislation and good public policy, which should be endorsed by this Committee.

The time to act is now, not later, less the product liability insurance situation develop to full crisis level again, without this Committee having acted when it was aware that it was coming, and had a remedy which it could have put in place.

Mr. Chairman, we have appreciated the opportunity to appear before you and your colleagues today.

The CHAIRMAN. Thank you, Mr. Marchese.

Mr. Mack, will the Risk Retention Act do away with the need for tort reform? In other words, isn't the current tort reform law the underlying problem.

Mr. MACK. Absolutely not, in response to your first question. The Commerce Department came to the conclusion, with which we agree, that there are essentially two causes of the product liability insurance problems which many of our members and many of Mr. Marchese's and other small businesses are facing. First, there are uncertainties, and in some cases inequities, in the tort system.

And second, the fact is that insurance rates today in many, many cases are not reflective of actual claims experience of our members. It is this second aspect of the problem which this legislation addresses.

We think that both aspects need to be addressed and that they need to be addressed quickly. As we indicated, we are testifying tomorrow in hearings that Congressman Scheuer and Congressman Preyer are beginning on tort legislation over in the House. But this bill needs to be passed now. For one thing, it will enable—may attract to the tort bills legislators who may not be totally amenable to changing the tort system because they feel, as Mr. Marchese says, that the principal beneficiary of those changes would be the insurance industry. That would not be the case if this bill passes. There would be an alternative market mechanism available. If insurers, in the event of passage of helpful tort law changes, would continue to charge what many of our members feel would be excessively high premiums in light of their claims experience—premiums which should be reduced if tort legislation passes—those premiums would be reduced because of this competitive mechanism being available.

The CHAIRMAN. Mr. Marchese, has your association attempted to form a captive insurance company?

Mr. MARCHESE. Not as of this moment, Senator. However, we are looking into it in light of the Risk Retention Act provisions with respect to the feasibility of it and the desirability of our members. We know many of the members in the commodity line associations are interested and have a very definite need for it. And of course, depending on the enactment date, we would be looking into it very closely, because we think it is a very necessary interim type of relief.

The CHAIRMAN. Well, now, the wholesalers indicate their support for risk retention, but isn't the real problem your members being sued in many product liability claims involving only design defects and no misconduct by the wholesalers?

Mr. MARCHESE. Yes. As Mr. Mack and we said, we feel there's a very definite need for tort reform, especially with respect to the application of product liability laws on nonmanufacturing sellers.

Our dilemma in this situation is that where we have had tort reform and we have taken this tort reform to the insurance industry and stated that we now have the relief with respect to reform of the laws that we were looking for, we no longer have strict liability in the designated States over, for instance, the liability for design defects, but we don't get a reaction from the insurance industry other than: "Let us wait and see."

We don't know what period of time they're talking about with respect to "wait and see." But for many wholesaler distributors who are going either without insurance today or with insurance at very low limits or buying insurance at very high premiums, they are facing a difficult competitive situation, being small businessmen. They're not able to continue very long in that kind of situation.

The CHAIRMAN. Mr. Packwood.

Senator PACKWOOD. Mr. Mack, in your statement you indicate that the great problem, in your perception, is the quantity of the product liability suits and the trendline toward liability without fault.

If, indeed, those were the two principal problems, how is that going to differ if you have group insurance or self-insurance?

Mr. MACK. Senator Packwood, this legislation, as we have indicated, does not address the tort system. It addresses insurance ratemaking difficulties. It provides a competitive mechanism whereby our members and others who feel that they are being charged excessive rates can look to another mechanism. They cannot effectively do so today.

It also, I think, will provide our members who have substantial deductibles or self-retentions to provide a way to cover those substantial deductibles or to perhaps increase them and thereby reduce the net cost of their insurance. In other words, by increasing the deductible or self-retention, and then by covering it through a risk retention group, you can reduce the overall cost of your insurance premiums.

Senator PACKWOOD. Is there no competitive shopping around among insurance companies when you want to buy product liability insurance?

Mr. MACK. Sure. And as we have indicated in our testimony, there is this year some easing of the market. But the insurance industry is a very cyclical industry, as I'm sure the insurance witnesses can tell you. And we take them at their word, that there is likely to be a tightening of the market in the early to mid 1980's.

We think that this facility ought to be in the law now.

Senator PACKWOOD. What do you mean, "a tightening of the market?"

Mr. **Mack**. In the mid-to-late 1970's, despite shopping around, nany of our members were unable to find any coverage at all. Last ear, 20 percent of our members reported to us that they were vithout affordable coverage.

Senator **Packwood**. Is that because there is a conspiracy among he insurance companies? In other words, I don't understand why ou can write it any cheaper as a group, assuming you've got to efend all the lawsuits and all the claims, "hairshirt claims," and ll the liability without fault.

I don't understand why the group can defend it any cheaper or o it any cheaper than a large insurance company.

Mr. **Mack**. Mr. Chairman, maybe it takes perhaps some degree of aranoia to be an insurance underwriter. But what has happened s that some of the largest increases in premium costs have accrued o members who have had no claims, who have never had a claim, nd who have seen their insurance premium costs over a period of or 4 years increase 14- or 15-fold.

Senator **Packwood**. Let me ask you—what you are saying is the nsurance companies are lumping it together and are, in essence, aying: "We don't care what your individual record is; we're going o lump you in with 15 other companies and average out the ecords."

Mr. **Mack**. Fifteen other companies who may or may not have he same exposure that you have, based on the type of machine ol that you make.

Senator **Packwood**. Are you telling me that the insurance comanies' rates for your whole industry and all of your members bear o relation to your industry-wide claim experience?

Mr. **Mack**. I think that that would be a fair characterization.

Senator **Packwood**. So the insurance companies are just picking out of the air, saying: "We will charge you x plus 100, whereas e'll charge somebody else x plus 50," and there's no rational basis r that conclusion?

Mr. **Mack**. That is the conclusion that we and many of our embers have drawn, Senator—certainly on the basis of the expeence of the mid-to-late 1970's. Now as I have indicated, there has een some easing as the cycle in the insurance industry has gone o.

Senator **Packwood**. The reason I ask you this, we all draw back our own experiences, but again, when I used to bargain labor ntracts, especially in the health field, you would shop around and occasion we would change to Aetna or Continental Casualty om Blue Cross. We'd get a better deal. We'd renew the contract; e might change again.

Are you telling me—you can do that in your group's health surance and life insurance, but for some reason you cannot, even th an individual business—I shouldn't use the word "group"— op around on an individual business, and get competitive rates? You're telling me this does not exist in product liability insurce?

Mr. **Mack**. It exists for some companies. It exists more today an it did 2 or 3 years ago.

We would anticipate, based on the insurance industry's own predictions, that it exists more today than it will 2 or 3 years from now.

Senator PACKWOOD. Now tell me again, the law that I don't understand. You are, at the moment, prohibited from buying or forming—buying group product liability or forming your own groups except in a few States?

Mr. MACK. Yes, sir. You are now addressing title II?

Senator PACKWOOD. Yes, sir. And that absent a change in State law—and you said Colorado and one or two other States may have some—you are prohibited from forming your own groups or buying group product liability insurance?

Mr. MACK. That is correct in most States.

Now to the credit of the insurance industry—and you might want to address this question to them—I am told that they have recently come to the conclusion that those laws at the State level are inappropriate and have offered to help try to get them repealed. We think that would be a useful enterprise.

But that, I think, is going to take an awful long time.

Senator PACKWOOD. You think part of their interest in doing that is the House passage of this Risk Retention Act?

Mr. MACK. Well, you would have to ask that of them, Senator.

Senator PACKWOOD. The reason I say that, in addition to bargaining labor contracts, I spent three sessions in the State legislature. At the time, with few exceptions, the usual attitude of the insurance industry was to oppose State laws allowing group insurance. There were some exceptions, but that was their usual attitude. That was 15 years ago. I don't know if it's the same now, but it was only if the pressure was great and it seemed inevitable, that they would slowly come around.

We spent three sessions trying to pass a homeowner's liability bill as opposed to having to purchase separate fire, burglary, and separate everything else. It was uniformly opposed by the insurance industry to allow that kind of grouping.

I have no other questions, Mr. Chairman.

The CHAIRMAN. Thank you very much, gentlemen.

We will next have a panel—Mr. James Shamberger, vice president, government relations, Reinsurance Association of America; Mr. Dennis Connelly, counsel, American Insurance Association; Mr. Donald Jordan, Alliance of American Insurers; Mr. J. David Rowland, chairman, Federal Affairs Committee, Independent Insurance Agents of America.

We'll start with Mr. Shamberger and we will make your statements part of the record in full. We ask that you summarize from them as best as you can because we are on a tight time schedule.

STATEMENTS OF JAMES M. SHAMBERGER, VICE PRESIDENT, GOVERNMENT REGULATIONS, REINSURANCE ASSOCIATION OF AMERICA; DENNIS CONNOLLY, COUNSEL, AMERICAN INSURANCE ASSOCIATION; DONALD L. JORDAN, ALLIANCE OF AMERICAN INSURERS; AND J. DAVID ROWLAND, CHAIRMAN, FEDERAL AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS OF AMERICA

Mr. SHAMBERGER. Thank you, Mr. Chairman.

We appreciate the opportunity to appear this morning as the committee begins its consideration of the Product Liability Risk Retention Act. This legislation has been suggested as a means to address product liability insurance cost and availability problems.

The Reinsurance Association of America is a trade association whose 23 member companies are principally engaged in the writing of property-casualty reinsurance. Terminology in the trade has designated insurers whose main business is reinsurance as professional reinsurers, not to imply other reinsurers are not professional.

The association's of member companies assume more than $4 billion of gross reinsurance annually.

Reinsurance as a technique is the assumption by one insurer, for a premium, of all or part of a risk originally held by another insurer.

In other words, it is the insuring of insurers. Reinsurance is usually classified as being either treaty or facultative, depending on whether a class of business or a specific risk is being reinsured.

Facultative reinsurance constitutes smaller overall premium for most companies than treaty, but is very important in areas involving special or larger risks, or risks in which special problems have arisen, such as malpractice and product liability insurance.

Perhaps due to the technical nature of reinsurance and the fact that it is not as frequently encountered as direct insurance, there is a mystique about the business which often results in inaccurate assumptions concerning reinsurers and reinsurance. Since the House report on H.R. 6152 reflects such a misconception, we thought it important to draw attention to the distinction between a reinsurer and a reinsurance transaction.

Specifically, I refer to the report language related to section 106, which seeks to preempt certain State laws. Reinsurance transactions are historically not subject to the same rate and form regulations applicable to insurers doing most types of business with the general public. There are a number of reasons for this, including the need to tailor the coverage to the particular requirements of the contracting parties, the worldwide and competitive nature of the market, and sophistication of the parties.

A company licensed to write direct business is generally entitled to write reinsurance without further regulatory approval. A licensed company which chooses to write only reinsurance is subject to the same solvency, reporting, and examination requirements which are imposed on a company which writes mainly direct personal lines policies.

Finally, some companies which are principally engaged in the business of reinsurance also write high-level direct excess coverage for which they are responsible for all applicable form and rate-filing requirements.

The association's members have followed with interest the Commerce Department's studies and efforts leading to the development of the risk-retention concept. While the efforts have been substantial, we believe that risk-retention proposal is a concept which is not needed by product manufacturers and distributors in general and will not meet the expectations of those businesses which are experiencing the worst product-liability problems.

However, to get to the legislation itself, I won't dwell on o comments concerning the product-liability market and our conv tion that our legal system is a major factor in the picture.

In the course of our review of the risk-retention proposal, have concluded there are two principal functions which risk rete tion groups might serve. One would be to facilitate the sharing deductibles under commercial insurance policies, while the oth would be to operate as a pooling mechanism to replace partially completely commercial insurance.

The second of these is the more significant and I will turn to th at this time.

At the outset, we would question, however, whether any Fede action is necessary to assist businesses in developing risk-shari mechanisms. Association captives and specially designed group p grams have assisted many difficult risks in obtaining adequa insurance.

Reinsurers are involved in several such plans. The attractiven of the existing system is that it provides protection through t cooperation of associations, insurers, and reinsurers within Sta regulated insurance marketplaces.

The State insurance regulatory system assures the stability insurers through its examination process and insurers worki with association programs assist them in maintaining themsel as viable groups.

If the risk-retention proposal is adopted, an unnecessary b competing federally regulated program will commence operati While it is arguable whether a competitive regulatory clima would be useful, we are troubled in some sections of the bill by t vagueness of the standards set forth to guide the Secretary's de sionmaking. In other areas, it's clear that the authority provid will not adequately arm the Secretary to deal with regulato problems which will be encountered.

As an example of inadequate specificity, we can cite the pro dures to be followed by the Secretary in reviewing an applicati for approval under section 101(b). While the factors listed appe appropriate, the standards for evaluation are to be developed the Secretary after enactment of the bill.

In other words, you cannot tell how licensing will be admin tered. In connection with the approval of risk-retention groups, would recommend the committee consider incorporating addition factors. First, since this legislation is intended to assist organi tions unable to find insurance or unable to find it at a reasonab rate, we would suggest that the application for approval of a ri retention group demonstrate to the satisfaction of the Secreta that adequate insurance markets are not available or that ins ance is available only at excessive rates or with unreasonab deductions.

Such a requirement, which is a provision contained in the Co rado and Tennessee captive laws, would also assist in limiting t bureaucracy which otherwise might be required by the prolife tion of unnecessary risk-retention groups.

Second, in order to assure that a risk-retention group is fin cially viable, the committee should consider a provision to requ a risk-retention group be able to generate a certain level of premium annually.

Third, in order to assure financial stability of risk-retention groups, consideration should be given to restricting a group's net retention to 10 percent of its capital and surplus. Such a limitation is comparable to State insurance codes.

Finally, also to assure the financial stability of risk-retention groups, the committee might want to study the advisability of restricting a group's net retained writings to capital and surplus to a fixed multiple.

In Tennessee, the ratio is 3 to 1, which is a generally accepted multiple in the insurance industry. Our point in making these suggestions is that if insurers are expected to do business with risk-retention groups, they will want to know what specific regulatory framework will be established.

Turning to another area, we have certain concerns regarding consumer protection. The Secretary is required under section 106(c) to promulgate regulations regarding claim settlement practices of approved risk-retention groups after considering similar provisions in the State law.

Even if the Secretary were to pattern his claims regulations after the comprehensive NAIC model, he appears to be granted no enforcement flexibility while the State insurance commissioner is specifically authorized to conduct hearings, issue cease and desist orders, and impose fines, as well as suspend insurers and revoke their licenses.

The Secretary's only two options provided in the text of the bill are the ability to threaten to revoke a group's approval or to revoke a group's approval. As a practical matter, revocation of approval for a single violation is not realistic and would probably never be attempted. The proper handling of claims is of considerable concern to reinsurers for two significant reasons, both related to the insurer's exposure at high liability levels.

First, if claims handling is conducted on an adversary basis, litigation may result in the delay of immediate and intensive rehabilitation assistance needed in serious physical injury cases. This delay could result in increasing the ultimate cost of rehabilitation or rendering an otherwise temporary injury permanent.

Second, improper claims practices can subject the risk retention group and ultimately its insurer to the perils of punitive damages, an increasingly troubled area for reinsurers.

We make several other suggestions in our statement of specific amendments which might be considered, regarding the area of solvency, the fact that we believe that staffing levels indicated in the bill and suggested by the Commerce Department are unrealistic, a number of technical suggestions relating to terminology in the bill the taxation of risk retention groups, and a suggestion concerning continuing the liability of a withdrawing member of the group for up to a 10-year period.

For the foregoing reasons, we submit that the risk retention legislation is not necessary and, in any event, would require significant amendments to be workable.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Shamberger.

[The statement follows:]

Statement of James M. Shamberger, Vice President, Government Relations, Reinsurance Association of America

The Reinsurance Association of America (RAA) appreciates the opportunity to participate in the hearings of this Committee on a proposed legislative solution to alleged product liability insurance cost and availability problems.

INTRODUCTION

The RAA is a trade association representing professional property and casualty reinsurers in the United States. Professional reinsurers are those insurance companies which are principally and substantially engaged in writing reinsurance in contrast to department and divisions of direct writing primary insurers which also may write reinsurance. The Reinsurance Association's twenty-three member companies assume more than $4 billion of gross reinsurance premiums annually.

The nature of reinsurance

Before specifically addressing the risk retention proposal it might be helpful to provide a general description of reinsurance and its function in the business of insurance.

Reinsurance may be defined as the assumption by one insurer, in exchange for a premium, of all or part of a risk undertaken originally by another insurer. The principal technical functions of reinsurance are to provide insurers with capacity enabling them to write policies in larger amounts than otherwise could be written; to share the financial burden of reserves attendant to the growth of premium income; and, generally, to reduce an insurer's net liability to amounts considered appropriate for the insurer's capital and surplus.

Treaty and facultative reinsurance

Reinsurance is commonly classified in one of two ways: treaty or facultative. In treaty reinsurance, protection is provided to an insurance company on a class of business. In facultative reinsurance, an insurance company is provided protection on a specific risk. In a reinsurance treaty the reinsured and the reinsurer agree that the reinsured will cede (transfer) and the reinsurer will assume (accept) the liability on a block or group of exposures according to a pattern set forth in the contract. Since almost all insurance companies buy some from of treaty reinsurance, it is the more prevalent type and its premium volume exceeds that of facultative reinsurance.

Facultative reinsurance compared with treaty reinsurance constitutes a smaller percentage of overall premium volume for most reinsurance companies. This type of reinsurance does, however, play an important part in reinsurance an will continue to develop in the furture. It has been very popular in areas involving special or larger risks and risks in which special problems have arisen, such as malpractice and product liability insurance.

Pro rata and excess of loss reinsurance

Reinsurance, whether facultative or treaty, is written in one of two forms, pro rata or excess of loss. The pro rata concept involves the sharing of all risks, often from the first dollar of loss, and the insurer and the reinsurer share premiums and losses on a previously established ratio. Excess of loss reinsurance agreements provide for the reinsurer to pay up to its agreed limit after the insurer has paid its underlying retention.

Reinsurers and reinsurance

Perhaps due to the technical nature of reinsurance and the fact that it is not as frequently encountered as direct insurance, there is a mystique about the business which often results in inaccurate assumptions concerning reinsurers and reinsurance. Since the House report on H.R. 6152 reflects several such misconceptions of reinsurance, we thought it important to draw specific attention to the distinction between a reinsurer and the reinsurance transaction.

Reinsurance transactions are historically not subject to the same rate and form regulations applicable to insurers doing most types of business with the general public. There are a number of reasons for this, including the need to tailor the coverage to the particular requirements of the contracting parties, the worldwide and competitive nature of the market and the sophistication of the parties. A company lincensed to write direct business is generally entitled to write reinsurance without further regulatory approval. A licensed company which chooses to write only reinsurance is subject to the same solvency, reporting and examination requirements which are imposed on a company which writes mainly direct personal lines policies. Finally, some companies which are principally engaged in reinsurance also write high level direct excess coverages for which they are responsible for paying state premium taxes as well as for complying with all applicable form and rate filing requirements.

In summary, insurers exclusively writing reinsurance are not granted a special status which would be lost by doing what might be characterized as direct business. Statements in the report to that effect are erroneous.

THE RISK RETENTION PROPOSAL

The Association's members have followed with interest the Commerce Department's studies leading to the development of the risk retention concept. While its examination of the product liability situation has been extensive and well-intentioned, we believe that the risk retention legislation is not needed for product manufacturers and distributors in general and will not meet the expectations of those businesses which are experiencing product liability problems. In the allotted time, we would like to make a few comments concerning our perception of the product liability problem, discuss the special concerns that reinsurers have about the risk retention concept; and, finally, identify some general problem areas in the bill which appear either to complicate it or diminish its effectiveness.

Product liability rates are up

No one questions that serious product liability insurance problems exist for some businesses. Increased losses attributable in part to social and economic inflation, increased frequency of claims, and catastrophic liability judgments have mandated upward movement of insurance premiums. However, the best evidence is that there is no crisis that would justify sweeping federal action. The insurance study conducted by the Interagency Task Force on Product Liability stated that, "Although the cost of product liability insurance has increased substantially in most industries, the problem of increasing costs is severe in only a few industries, such as industrial machinery, industrial chemicals, automotive components, and pharmaceuticals."

The legal system is a major factor

Substantial evidence has been presented to support the proposition that a principal factor in the escalation of product liability insurance rates is the present operation of the tort and judicial system. Specifically, changing tort law during the last several years has gradually imposed upon a manufacturer increasing responsibility for indemnifying persons injured through use of a product. The expanding judicial view has been that manufacturers are able to compensate for the injuries since such expenses can be built into the cost of the product.

Although the identification and allocation of the expenses resulting from this judicial change were initially carried out imperfectly by the insurance rating mechanism, the recent refinement of statistical plans should assist the insurance industry in allocating losses more accurately and developing rates more precisely in the future. While these improvements should respond to some of the concerns expressed over the lack of information in the past, one must recognize the importance of underwriting analysis and judgment in dealing with this difficult area.

THE ROLE OF REINSURERS IN THE RISK RETENTION CONCEPT

In the course of our review of the risk retention proposal, we have concluded that there are two principal functions which risk retention groups might serve. One would be to facilitate the sharing of deductibles under commercial insurance policies while the other would be to operate as a pooling mechanism to replace, partially or completely, commercial insurance.

Low level risk sharing

Under the first scenario, a risk retention group would, in effect, act as an insurer offering low limits approximately equalling present policy deductibles. These limits, perhaps providing first dollar coverage, would meet the objectives of those businesses protesting the deductibles which they are required to assume under commercial policies.

The cost of operating a pooling mechanism offering ground level protection would, however, impose expenses on the group which might be better borne by the members themselves. Ground level coverages, whether in a commercial policy or a family automobile policy, are generally uneconomical and contrary to sound insurance risk management.

Above the pooling limits, members would probably purchase individual excess policies or perhaps a group policy as permitted under Title II. Such an operation would probably not involve reinsurance except to the extent that a company provi ing excess coverage might wish to reinsure part of its risk.

Partial replacement of commercial policies

The second and more likely method of operation would replace existing comme cial product liability protection. Risk retention groups of this nature would probabl require reinsurance.

At the outset, we would question whether any federal action is needed to assis businesses in developing risk sharing mechanisms. Association captives and special ly designed association programs are used presently by many groups to achieve th objectives of economy and special coverages. Reinsurers are involved in several suc plans.

While state laws may make special programs more difficult to organize, it ca generally be accomplished. Ingenuity on the part of brokers and specialty companie has made insurance available for many difficult risks.

The attractiveness of the existing system is that it provides protection throug the cooperation of associations, brokers, insurers, and reinsurers within the stat regulated insurance marketplace. The state insurance regulatory system assures th stability of insurers through its examination process and insurers working wit association programs assist them in maintaining themselves as viable groups.

It appears that many of the proponents of the risk retention legislation ar manufacturers or distributors in troubled product lines who are unable to for affordable association or group programs or obtain individually what is considere affordable insurance. A risk retention group formed of companies in troubled line should not realistically expect to achieve rate relief because when difficult risks in single line are channelled to one entity, insurance for the risks simply may b unaffordable because of the potential presence of too many losses.

Nor should a risk retention group consisting of producers with product liabilit problems anticipate better results than at present due to its direct access to th reinsurance or excess insurance market. Reinsurance is not wholesale or cut-rat insurance and the proper premium charged a producer should not differ whethe the primary insurer's retention is $5,000 or $5,000,000.

REGULATORY STANDARDS OF THE RISK RETENTION ACT

If the risk retention proposal is adopted, an unnecessary but competing federall regulated program will commence operation. While it is arguable whether a compe itive regulatory climate would be useful, we are troubled in some sections of the bil by the vagueness of the standards set forth to guide the Secretary's decision-makin In other areas it is clear that the authority provided will not adequately arm th Secretary to deal with the regulatory problems which will be encountered.

Lack of standards—approval of risk retention groups

As an example of inadequate specificity, we could cite the procedures to b followed by the Secretary in reviewing an application for approval under Sectio 101(b). While the factors listed appear appropriate, the standards for evaluation ar to be developed by the Secretary after enactment of the bill. In other words, on cannot tell now how licensing will be administered. The Secretary might constru the Act to grant him unbridled authority to approve groups as he deems appropri ate. On the other hand, if the Secretary chooses to examine the listed factor critically, as he should, it would require the use of experts in the fields of financ actuarial science, engineering, insurance and management.

In connection with the approval of groups, we would recommend the Committe consider incorporating two additional factors. First, since this legislation is intende to assist organizations unable to find insurance or unable to find it at a reasonabl rate, we would suggest that the application for approval of a risk retention grou demonstrate to the satisfaction of the Secretary that adequate insurance market are not available or that insurance is available only at excessive rates or wit unreasonable deductions. Such a requirement, which is a provision contained in th Tennessee captive law, would also assist in limiting the bureaucracy which other wise might be required by a proliferation of unnecessary risk retention group Secondly, in order to assure that a risk retention group will be financially viabl the Committee should consider a provision which would require that a risk rete tion group be able to generate a certain level of premium annually. Perhaps i should be in the range of $1,000,000 as required in the Colorado and Tenness captive laws.

Inadequate regulatory flexibility

In two significant areas, we believe the Secretary is provided inadequate authority to deal with regulatory challenges he may face. These are the sections related to consumer protection and solvency supervision.

Consumer protection.—The Secretary is required by Section 106(c) to promulgate regulations regarding claims settlement practices of approved risk retention groups after considering similar provisions of state laws. The provision is intended to meet concerns over the inability of the Secretary to protect the public which were expressed during House consideration.

Even if the Secretary were to pattern his claims settlement regulations after the comprehensive NAIC model, he appears to be granted no enforcement flexibility. While a state insurance commissioner is specifically authorized to conduct hearings, issue cease and desist orders and impose fines as well as suspend insurers or revoke their licenses, the Secretary's only two options provided in the text of the bill are to threaten to revoke the group's approval or to revoke the group's approval. As a practical matter revocation of approval for a single violation is not realistic, and would probably never be attempted.

Supervision of Solvency.—Though one could hope that the Secretary would never be faced with the prospect of a failing risk retention group, it would be unrealistic to ignore that possibility. Federally supervised banks, credit unions, and savings and loan associations sometimes fail even through they are subject to strict regulation.

It would appear probable that over time one or more groups would be identified through examination or from reports filed with the Secretary as being financially troubled. If one accepts this premise and looks to the proposed bill for authority to conserve, rehabilitate or force the group to suspend its operations, he will be disappointed. The power of the Secretary as to an impaired group is limited to moral suasion or revocation of its approval. Of course, revocation is also subject to thirty-days notice and would be appealable. Careful and serious consideration should be given to providing the Secretary flexible authority to tailor a response to meet the conditions presented including the power to take immediate action when a group is in such a condition to be hazardous to the public or to holders of risk retention agreements.

On a somewhat related point, there is no suggestion in the text of the bill as to what steps the Secretary is to take when a group is clearly insolvent. This issue should be addressed as well as the relationship of the Act to the Federal Bankruptcy Act.

Unrealistic staffing levels

Perhaps in order to allay concerns which might be expressed over the growth of the government bureaucracy, the Commerce Department has placed great emphasis on the small number of employees which would be required to administer the program and how costs would be distributed among the groups, thus minimizing federal expenses.

We believe that the committee should consider whether it is in fact probable that the small numbers referred to could effectively administer the risk retention program and whether, if there were few groups organized, it would be feasible to pass on all the direct costs of the activity.

SUGGESTED TECHNICAL AMENDMENTS

Our remaining observations relate to aspects of the legislation which we believe reflect deficiencies in the bill which should be considered regardless of the committee's opinion on the larger question of whether or not the legislation is necessary or appropriate.

Sunset provision

Section 304(b) provides that the act shall terminate four years after its effective date if on that date there exist no approved risk retention groups. Inasmuch as it would be relatively easy to keep a single group in existence, it seems appropriate to require that a meaningful number be in operation, perhaps in the range of ten to twenty. This would also make somewhat more plausible the assertion of the Department of Commerce that the program is to be self-sustaining, relying on assessments for financial support.

Public information

Section 109(b) provides that copies of reports submitted under the act cannot be compelled to be disclosed. It seems incongruous that risk retention groups which are to submit annual reports on forms similar to those used by the NAIC would be able to keep them confidential while no such confidentiality is provided for the annual statement required of insurers. While information on an application or supplementary report could be deemed appropriate for confidential treatment, the annual statement certainly should not.

Inappropriate use of term "reinsurance"

In Section 101(b)(5) the Secretary is to consider the adequacy of "insurance" in approval of risk retention groups. In Section 3(b) the term "insurance" is defined to mean primary, excess, surplus line insurance, reinsurance, and other risk shifting devices. The title to Section 102, however, is "reinsurance" and that term is used at least seven times in the section. we would recommend the substitution of the term "insurance" since it is defined as meaning the several specific types, any of which could be used to meet the requirement of the act.

Taxation of risk retention groups

Section 106(b) refers to the right of a State to collect a premium tax such as that levied on admitted insurers and "surplus line insurers." In fact, surplus line brokers or surplus line policy purchasers are subjected to these taxes, not the surplus line carriers.

Additionally, although Section 106(b) pays lip service to the right of a State to collect these taxes, the House report indicates that most States would need to enact special tax laws for risk retention groups since State premium tax laws refer to "insurers" and risk retention groups, are, by definition, not insurers.

Withdrawal procedures

Section 103(d) establishes a five-year cut-off for the return of a withdrawing member's capital contribution. The bill is silent as to any responsibility of the withdrawing group for subsequently developed claims. Since these groups will be dealing in product and completed operations liability which have long development periods, it is possible that only about 70% of the losses may be accounted for at the end of five years. We would suggest the possible amendment of this section to provide that a withdrawing member would be subject to assessment for ten years but would not be liable thereafter.

SUMMARY

For the foregoing reasons, we respectfully submit that the risk retention legislation is not necessary, and, in any event, would require significant amendments to be workable.

The CHAIRMAN. Senator Culver has just arrived and Mr. Shamberger, if you will give up your chair for the moment, we can hear from Senator Culver and then go on.

Senator Culver, we're happy to have you here with us.

STATEMENT OF HON. JOHN G. CULVER, U.S. SENATOR FROM IOWA

Senator CULVER. Thank you very much, Mr. Chairman, Senator Packwood.

I very much appreciate this opportunity to testify before the committee on the Product Liability Risk Retention Act.

The difficulties which products-sellers face in obtaining adequate insurance for product liability at affordable costs have been a special personal concern of mine since 1976, in September, when I chaired a hearing by the Senate Small Business Committee on this subject.

I believe that was the first congressional inquiry into this problem and enabled us, I hope, to sketch the outlines of the situation which has since been fully illustrated by further hearings of the Small Business Committee of both the House and the Senate, the House Ways and Means Committee, and the Senate Finance Committee and, of course, this panel itself.

In addition, of course, the comprehensive investigations of a Federal interagency task force chaired by the Department of Congress have provided a comprehensive data base and thorough analysis of the nature, extent, and causes of the problem.

Because that record has been so fully elaborated, Mr. Chairman, I will not take up the committee's time with a detailed description of the problem. Let me limit my remarks to citing three major conclusions from the evidence of all the studies.

First, the costs of product liability insurance coverage, relatively minor for many years, skyrocketed in the 1970's. Whole industries confronted a doubling or tripling of premiums each year while for individual firms, annual increases of 1,000 percent were not uncommon.

Second, it was clear that a variety of factors ranging from inequities and inconsistencies in tort law to the manufacture of unsafe products to the operation of some workers' compensation contributed to the crisis. However, those factors neither singly nor in combination justified the insurance cost explosion. Instead, concluded the task force, those rates reflected panic pricing by insurers.

Third, as is so often the case, the real brunt of the product liability problem fell on small businesses.

In response to the problem, a wide range of Federal and legislative solutions have been proposed. As you are aware, a uniform tort law, an SBA reinsurance program, minimum standards for Worker's Compensation, and tax-free self-insurance reserves are among the ideas which have been introduced in Congress.

Despite all the study, documentation, and policy suggestions, however, Mr. Chairman, so far Congress has enacted only one measure to attempt to alleviate these severe problems. Included in the Revenue Act of 1978 is an amendment which I introduced to allow businesses subject to product liability losses to carry them back and apply them against the previous 10 years of taxable income.

A 3-year carryback provision is permitted for most business losses. Under this provision, a firm could use taxes previously paid as at least a partial reserve against uninsured losses.

This new provision of law is useful for firms who cannot obtain any insurance at all. But for the great majority of firms, affordability rather than availability is the issue.

It is precisely the issue of affordability which the Risk Retention Act addresses. It was this kind of immediate attack on affordability difficulties that I urged upon on the task force director, Professor Schwartz, during his work at the Commerce Department.

I was please, therefore, to introduce the Risk Retention Act in the Senate last September. It is cosponsored, as you are well aware, by Senators Nelson, Inouye, Pressler, and Tsongas.

In a nutshell, this legislation has two basic parts:

First, it exempts risk retention groups of businesses from State insurance regulations so that they may form insurance-pooling arrangements. This bill permits such groups to be formed if approved by the Secretary of Commerce after examination of such factors as a group's financial assets, managerial expertise, loss prevention efforts, reserves, and other relevant factors.

Second, this legislation will permit the group purchase of product liability insurance through the regular commercial market, a practice which is prohibited in a majority of States.

My purpose this morning, Mr. Chairman, is not to offer a description of the detailed workings of the Risk Retention Act. Instead, let me describe just briefly four characteristics of the legislation which, in my judgment, make it a particularly attractive and useful approach to easing product liability problems.

First, it serves the legitimate needs of products-sellers and product-buyers—both business and consumer interests. Most proposed answers to the product liability problem in my experience present difficulties because they are viewed by various interest groups as a zero sum game.

If a business seems to be advantaged by a certain approach, then the consumer losses. But I think here we have an approach where a consumer and business can simultaneously gain.

Risk retention by making coverage available to those who currently cannot obtain it at all may mean the difference between survival and bankruptcy for a firm hit by a major adverse settlement. At the same time, it may mean a consumer whose injury would otherwise go unredressed would receive just compensation.

Similarly, more affordable coverage through risk retention would protect both the profit margins of firms that pay exorbitant rates for conventional insurance and the pocketbooks of consumers to whom the costs of such rates are invariably passed on.

The wide range of support which the bill has received by manufacturing, general business, consumer, and public interest groups, I believe, testifies to its equity.

A second attractive feature of this legislation is that it represents a market solution to product liability problems with no cost to the taxpayer. The course of investigation of these problems produced numerous policy suggestions for a solution through the Government. Making the Small Business Administration, in effect, a reinsurer of last resort was one such typical early suggestion.

Even those most in need of better product liability protection were understandably reluctant to endorse yet another Federal program replete with new sets of rules and regulations, a new bureacuracy, new reams of paperwork and redtape and new expenditures of taxpayer dollars. Consistently, throughout the 3½ years during which I have worked on product liability, business groups have favored approaches which reserved initiative and decision-making to the maximum responsible degree to those best able to execute them—the firms themselves. Risk retention is precisely such an approach.

No one is compelled to form or join a risk retention group. It is an option which business managers may exercise if and to the extent that the particular circumstances of their own situation argue for it. Its principal reliance is on free enterprise and business judgment, not on governmental intervention or dictate.

The third reason I think think risk retention is a valuable concept, Mr. Chairman, is that it is consistent with the healthy trend we are taking toward reducing regulation. Certainly, it's very nature—to inject greater competition and thereby reduce costs—illustrates the best aspects of deregulation. In addition, the provisions of the bill itself directly unburden businesses of regulations which are appropriate only for commercial insurers.

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It is true that risk retention groups will have to conform to guidelines set by the Secretary of Commerce. But the enthusiastic support which business groups have given this legislation makes it clear that they acknowledge this regulation as necessary and, at the same time, are confident such requirements can be equitable and reasonable.

Fourth, and finally, this bill is attractive—almost uniquely so—in that it is a substantial answer to a major problem, with no cost to the taxpayer.

The administrative costs entailed by the legislation would be met by member fees, so that the measure will be self-supporting.

At a time when fiscal restraint and budgetary austerity are the rule, a cost-free approach to problems of national scope are rare and valuable. I hope we will not miss the opportunity to enact this one when the times comes in Congress.

It offers, in my view, Mr. Chairman, the best and the most immediate practical step we can take for both business and consumers. And I would urge the Commerce Committee to act favorably and promptly on the legislation.

The CHAIRMAN. Thank you very much, Senator Culver.

Senator Packwood.

Senator PACKWOOD. No questions, Mr. Chairman.

The CHAIRMAN. We appreciate your being here.

Senator CULVER. Thank you very much.

The CHAIRMAN. Next we will hear from Mr. Dennis Connolly, counsel, of American Insurance Association.

Mr. CONNOLLY. Thank you.

I do have a full statement, which I presented to the staff of the committee.

The CHAIRMAN. It will be put in the record, in full, and you may summarize from it.

Mr. CONNOLLY. The American Insurance Association is a trade association composed of property casualty insurance. There are 150 members, and our members provide the majority of the product liability insurance written in the United States.

I am pleased to be able to address the Senate Committee on Commerce, Science, and Transportation on the Risk Retention Act. We object to the Risk Retention Act on the grounds that it is an unnecessary Federal intrusion into the area of insurance.

It does not address product liability problem causes. In fact, to a certain extent, it may mask them, with deleterious results which will appear later on.

Groups wishing to form insurance groups can do so right now. And they can do it through the mechanisms provided not only by the States of Tennessee and Colorado, but in other jurisdictions, both in the United States and outside of the United States.

Senator PACKWOOD. Mr. Chairman, let me make sure I understand that. You say it's very easy for businesses now to form groups in any State in this country?

Mr. CONNOLLY. In several States, there are mechanisms which they can avail themselves of which permit them to provide insurance services throughout the United States.

Senator PACKWOOD. I understand, several States—I said "any State."

Mr. CONNOLLY. It they meet certain provisos, which may be higher in other States, then they can meet additional requirements in other States and form companies to sell insurance.

Senator PACKWOOD. I want to get an answer on the record. Is it easy for businesses in every State in this country to form groups for purposes of product liability insurance?

Mr. CONNOLLY. The difficulty that I have is with the word "easy." It can be done—if you meet the appropriate requirements, it can be done. And the substance of my testimony, I believe, will demonstrate those requirements—the requirements outlined by the Department of Commerce—do not constitute insurmountable impediments.

Senator PACKWOOD. Would small businesses regard those requirements as unnecessarily burdensome?

Mr. CONNOLLY. I don't think they should.

Senator PACKWOOD. OK.

Mr. CONNOLLY. So that, for example, just to respond to that particular question, the National Association of Wholesale Distributors has among its constituent members some 45,000. There obviously is a sufficient body to meet those regulatory requirements. In fact, we have had meetings with executives of the National Association.

Senator PACKWOOD. Let me interrupt further. Take a company like Heister in Oregon, makes lift trucks, has a great potential product liability. There's a variety of other manufacturing outlets and spots and in the United States. It manufactures worldwide.

What does a company like Heister do if it thinks it cannot get adequate liability insurance? What does it do to self-insure, or how does it form one of these groups?

Mr. CONNOLLY. It can. There are a variety of mechanisms. It's not just one mechanism that is available. It can join, for example, an association captive.

Senator PACKWOOD. Association what?

Mr. CONNOLLY. Association captive—let's say the Association of Fork Lift Manufacturers.

Or, if Heister is large enough, it can form its own captive. It can do with either in one of the States, or it can do it offshore, or it can form arrangements where it takes either a retention or self-insurance with an insurance company; so that there are a variety of mechanisms under which companies can achieve end results, which to them are satisfactory.

One of the reasons that many companies do not do this is that it is not desirable when compared with the competitive commercial market. Product liability market is extremely competitive.

There are hundreds of insurers providing product liability insurance. Even the largest company has less than 7 percent of the U.S. market. The company behind that has less than 4 percent. And below that it falls off even more markedly.

The market has responded, as I indicated, with different mechanisms to respond to the different needs of the companies and the insureds. It is an area where you have judgmental rating, where rating is done by an underwriter and by loss control people, by the agents and brokers functioning for the insured, and by the insured, where the insured can sell itself. He can sell the company and can obtain different rates from different companies. And if he shops around, he can get what he wants.

The case for nonparallel regulation—that is, different or inconsistent regulation in product liability—particularly at the Federal level, has simply not been established as necessary.

The Risk Retention Act, on the one hand, offers the appearance of lax—or absence of regulation. On the other hand, it is totally unspecific in terms of what regulation will exist, what enforcement powers may exist.

Every regulatory decision, every enforcement decision will be an experiment in the structuring of the risk retention groups. There is in the Risk Retention Act, in section 302, absolutely unlimited regulatory and rulemaking authority vested in the Secretary. No one entering a risk retention group will be able to tell what they are getting into.

The impediments identified by the Department of Commerce as barriers to the formation of insurance companies are primarily capitalization requirements, insolvency mechanisms, residual markets, and reporting requirements.

There exists in many States laws which grant the Commissioners the authority to make available insurance which the Commissioner has deemed to be essential to the needs of the State, and which he has decided is unavailable.

These are among the mechanisms that the risk retention groups would be exempted from. This is rather unfortunate because the risk retention groups, by being withdrawn from the State market, may in fact cause availability problems within the States.

Reporting requirements are cited as an additional problem that risk retention groups ought to be exempted from. The fact is that the Department of Commerce has cited the need for additional statistical information on product liability, and that information is being gathered in many cases. Some reporting requirements are burdensome and counterproductive, but the Department of Commerce has not appeared to limit those particular reporting requirements.

Nevertheless, to the extent that reporting requirements gather information on product liability, it is appropriate that they capture the entire market.

Capitalization and insolvency are closely related. Without sufficient capitalization and premiums involvencies are likely to occur. This is the reason these requirements were established in the past.

It was abundantly clear, under the old product liability law, that this was a real possibility. Even with an insured financing deductibles, as is done in the Department of Commerce, hypotheticals, the possibility of a brush fire loss spreading through an entire industry is real and genuine.

Unlimited liability can occur—even with the $85,000 deductibles used in the Department of Commerce hypothetical scenario. The Department of Commerce has noted that key changes are likely to occur in the near future in the area of product liability. The Department said:

> Recent appellate decisions in California, New York, and New Jersey have expanded the liability of product sellers, have created more confusion as to sellers' legal responsibilities. These factors could have severe repercussions in the near future on both availability and affordability of product liability insurance.

These legal changes, I would remind you, are changes which will affect both the groups and the commercial insurance group.

New Jersey has adopted a decision in the case of Sutter, which has been rejected even in California. In California, in the case of *Barker* v. *Lull,* the court, in an ominous footnote, said:

> In the instant case, we have no occasion to determine whether a product which entails a substantial risk may be found to be defective, even if no safer alternative design is feasible.

That footnote calls for the possibility of a total no-fault compensation system for product liability. It means an injury, when someone cuts their finger on a knife, may be compensable.

The most dramatic case in product liability in recent years occurred 32 days ago, on March 20. It is the Sindell decision. It applies across the board to all kinds of products.

And establishing a risk retention group, particularly without adequate capitalization and without a backup of an insolvency program, is courting disaster with a decision such as Sindell.

Sindell says where there is a common design defect, not necessarily a negligent defect or a defect based on traditional concepts of fault, but a common design or construction defect, and where the identity of the seller, distributor, or manufacturer is lost, there will be a provision for compensation to the plaintiffs based upon the market share of defendants participating in that market.

All of this increases the chance of a severe insolvency under the guise of Federal approval.

I would like to give you some idea of the magnitude of the *Sindell* case, and it's a case which is being followed on cases moving up to the highest court level in other States. But it has reached the highest court in California.

It is alleged by plaintiffs that between 500,000 and 2 million women use the estrogen DES or virtually identical other estrogens. Between 300 and 3,000 have developed clear cell adinocarcinoma.

There have been two recoveries in those case. One was for $500,000; the other was for $800,000. It is further alleged by the plaintiffs and supported by a report from the Department of HEW task force that DES also causes adinosis. The cases of adinosis are speculated to be between 30 and 90 percent of the users. That is 150,000 to 1,800,000 individuals.

The State of Massachusetts has, for product liability using DES—has established a conditional class action on behalf of all plaintiffs in that State. The number of plaintiffs in the conditional class are between 13,000 and 53,000.

The Federal Government should not usurp the State's successful regulation in this area. To the extent that the Department of Commerce perceives problems, it ought to work with the NAIC and States to resolve them. It should not authorize the substitution of the illusion for the substance of insurance.

If it does so, it should expect the Department of Commerce to be back again and again and again to repair its errors and perhaps expand its authority. It would be back to cover those groups which have failed.

The Federal Government should not change the mechanism that is working without a real showing of need and a showing that existing State regulations are anything but reasonable, statutory-based requirements upon which an insurer's strength can be tested.

Thank you.

[The statement follows:]

STATEMENT OF DENNIS R. CONNOLLY, AMERICAN INSURANCE ASSOCIATION

My name is Dennis Connolly, I am Counsel with the American Insurance Association, which is a trade association of 150 publicly-owned insurance companies in the property casualty lines. Our members provide the largest share of the product liability market. I appreciate the opportunity of addressing the Senate Committee on Commerce, Science & Transportation. The American Insurance Association has been asked today to testify on the Risk Retention Act.

GENERAL POSITION

The Department of Commerce proposal creates a new unneeded regulatory scheme. It is a regulatory scheme which thwarts the efforts of states to regulate the business of insurance and to protect their citizenry. It totally ignores existing state sanctioned self-insurance and risk retention mechanisms, such as reciprocal insurers, which would serve the needs of the business community without sacrificing state regulatory protection in the area of solvency and claimant protection. It is a mechanism which asks the accident victims of the future to entrust their rights of recovery for losses to high-risk enterprises whose solvency and financial stability will be inadequately regulated and not guaranteed. It is a major and significant proposal which includes both federal chartering of insurance companies and a partial repeal of McCarran-Ferguson. These two proposals themselves have been recognized as major alterations of the antitrust legislation of the United States and are under vigorous study at this time.

The risk retention groups are nothing more than mutual insurance companies, reciprocals or association captives, all of which exist today under the laws of the several states, even where there are regulations covering their formation. Neither the states' laws nor their justification for enactment ought to be cavalierly disregarded.

In addition, neither the introduced legislation nor the Department of Commerce draft has been carefully though out in terms of either draftmanship or economic consequences. The effect this proposal will have on the existing insurance market and the relationship it will bear to existing law has not been addressed. The failure to consult with those who do possess insurance expertise, including state regulators, has resulted in a proposal which may result in serious distortions in the existing market without any apparent improvement for the purported beneficiaries of the Act. Questions concerning the level of regulation, the nature of regulation and antitrust implications all remain unanswered, with the probable result of either regulatory gaps or costly, duplicate, inconsistent regulation.

The risk retention concept does not address the underlying causes of product liability costs. It does nothing to change or rationalize tort law. No cost reduction is possible under these circumstances, only the dangerous illusion of savings. Finally, this entirely questionable concept would be achieved at the very considerable expense of the creation of a brand new bureaucracy on the federal level at the very time when it is most clearly recognized that expansive bureaucracy and unfettered rulemaking authority are neither economical nor beneficial.

THE GROUP CONCEPT

The concept embodied in the Department of Commerce proposal is not a new one. In fact, risk retention groups can be formed today at the state level under Insurance Code provisions authorizing mutual insurance companies or reciprocal insurers. Such groups exist today. It is true that certain regulatory requirements enacted by the States for the benefit of their citizens, based upon the experience of over 100 years of state regulation, would have to be met. We will address this more specifically later in this paper.

Moreover, any group not wishing to comply with those state regulations or the regulations inherent in the Risk Retention Act can form a group to function offshore, particularly in Bermuda. When formed offshore, regulatory restrictions are few. Yet, despite this latter option, relatively few offshore groups have been formed for products liability exposures, thus casting grave doubt on the necessity for still another mechanism. Groups have not been formed for product liability because they are impractical and because a commercial market exists now. State regulation is not the reason for their limited existence.

THE PRODUCT LIABILITY MARKET IS EXTREMELY COMPETITIVE

Product liability insurance is readily available and extremely competitive. Recent experience has demonstrated, contrary to statements in support papers prepared by the Department of Commerce, that not only have prices for such insurance stabilized but, to an extent, there has been a downward trend. The Department of Commerce concedes that rate levels stabilized in 1977 and 1978, but speculates there may be increases in 1979. Actual experience is, however, to the contrary. The latest rate filings by the Insurance Services Office for 1979 were for a substantial average reduction when compared to 1978. When there are increases in liability costs, they are caused by changes in the law of product liability. They will be felt by groups as well as insurers. Neither can avoid these costs.

There are hundreds of insurers providing product liability insurance throughout the United States. Even the largest insurance companies have relatively small shares of the market. According to A. M. Best, the largest single company in the business possesses a market share of only 7 percent. The second largest has slightly over 5 percent. This is followed by five companies that range between 3 percent and 4 percent. The fifteen top writers of general liability insurance wrote only 52.4 percent of the business in 1977. The remainder is spread across the large spectrum of insurers who are actively competing for this line of business. Indeed, insurance is readily available and although the possibility to form groups has existed, it has not been taken advantage of in the product liability line because the product liability market is competitive and because the cost advantages espoused by the support documents developed by the Department of Commerce have simply not been borne out when tested against actual experience.

It has been claimed that the use of deductibles is leaving certain insureds, in effect, uninsured or underinsured. This allegation is completely unfounded. A survey of our member companies indicates that, by and large, the use of deductibles is restricted only to instances in which there is a high frequency of injury with relatively low severity. When that combination is met, the use of deductibles is a viable alternate plan which leads to reduced premiums and cost savings for an insured. Often, it is the insured who prefers such option. It is not likely to have such a result when a firm is subject to claims which are few in number but likely to be severe. There are, in addition, a great number of alternate plans in the product liability market which make it possible for an insured to select competitive prices and competitive plans which are suited to its own needs.

NONPARALLEL REGULATION AND UNFAIR COMPETITION

The Department of Commerce and legislative proposals to create risk retention groups will have the effect of creating a dual and probably inconsistent regulation of product liability insurance. To the extent that commercial insurers are subject to regulations which the risk retention groups would be able to avoid, the latter will be given an unfair competitive advantage. The Department of Commerce papers, in a glaring inconsistency, claim that the State's regulations are a "substantial and costly" burden; yet, although these groups would be exempt from that costly burden, the Department claims they would not enjoy a competitive advantage.

The language of preemption contained in the draft is ill-considered and all-encompassing. All state law which regulates the groups and those who provide them with services is obliterated. State licensing laws and standards are voided by the all-encompassing language contained in the bill.

REGULATIONS

To date, the regulations which concerns the formation of an insurance company in the states for product liability have been described by the Department of Commerce as burdensome impediemnts or barriers. They have been discussed by the Department of Commerce solely in those pejorative terms without any detailed examination of the origin, merit or need for such regulations. The degree to which the regulations may constitute an impediment has never been assessed by the Department of Commerce in terms of whether they would actually impede the formation of any product liability insurance group at the state level.

The Department of Commerce has said in its Overview (page 1) that "Groups formed for the limited purpose of providing product liability risk protection to its members would have insufficient capital and economy of scale to support the regulatory framework of the states in which it would have to operate." It further states, "This explains why the private sector is not responding to the product liability problem by creating mechanisms like risk retention groups in the United States." The Department then concludes, "This is the rationale for this legislation * * * which would facilitate the formation and operation of these groups by, *inter* *alia*, exempting them from inappropriate state requirements which are premised upon the commercial insurer dealing with the public at large."

Several states have already responded to this alleged need by providing mechanisms under which captive insurance companies may be formed with different requirements than those established in the states for commercial insurance companies. The most well-known of such laws exist in Tennessee and Colorado. Captives and captive insurers formed in those states may provide insurance to insureds located anywhere in the United States. They may not, without qualifying in additional states, solicit insurance, which of course is a purely commercial insurance function. These laws and other laws (mutual, stock and reciprocal formation laws) in other states demonstrate the ability of the states to respond to the needs of the insurance-consuming public.

Regulations which are mentioned by the Department of Commerce as being inappropriate to the regulation of non-commercial insurers should be discussed in terms of their appropriateness to insurance groups such as those suggested under the Risk Retention Act. The Department of Commerce, in its Overview, has proposed two hypothetical strategies for group formation at a state level. Under both of the strategies, the members would be financing deductibles of $85,000. The Department of Commerce's examples do not state whether the deductibles are for individual claims or aggregate deductibles. The Department concludes that under the two strategies proposed in the states, one of the initial requirements would be the payment of paid in capital, surplus and deposits. Under the two hypothetical scenarios, the 20 members of the insurance group would be required to provide something under $4,000,000 in order to form as insurers in the states listed in the examples. It should be noted that these base payments support the assumption of potential liability year after year. An insurer providing $85,000 per claim for its insureds is subject to unlimited liability year after year after year.

It is, practically speaking, inconceivable that in the modern tort climate, particularly in the area of product liability, an insurance company composed of 20 or more member companies would ever be allowed to form with a capitalization deposit and surplus of less than $4,000,000. Traditional insurance principles concerning the degree of risk in proportion to assets would defeat that option. Even financing deductibles for such groups requires capital greater than that required by the states. Also, the requirement that generally no member of the risk retention group would pay more than 5 percent of the fees to this group would generally result in groups that were substantially larger than 20. However, if the 20 members were to be hit with judgments equal to the deductible, half of the capital would be instantly depleted. In addition, of course, in product liability for every $1 of indemnity paid, more than $0.40 is expended in defense related costs. Today's product liability climate simply will not permit the formation of groups with the severely limited capitalization the Department of Commerce apparently envisions.

The insurance industry, in testimony previously offered, has stated that the product liability market is extremely competitive. The Department of Commerce, in a response to the NAIC statement in the House of Representatives (see page 15 of the January 29 memorandum to Homer E. Moyer from Victor Schwartz), indicates that the alleged stabilization of the product liability market may receive severe shocks in the near future. It states that an underwriting downturn is anticipated. According to the Department, the downturn will be because "Recent Appellate Court decisions in California, New York and New Jersey have either expanded the liability of product sellers or created more confusion as to the sellers' legal responsibilities. Both of these factors could have severe repercussions in the near future on both the availability and affordability of product liability insurance." It is true that some recent trends, particularly in the states cited but in other states as well, render the possibility of forming federally authorized risk retention groups without meeting the minimum requirements of the states and particularly the backup of an insolvency mechanism extremely unlikely.

The most recent breakthroughs are such that there can now be industrywide recoveries. The doctrine of "market share" liability has been accepted. In the case of *Sindell* v. *Abbott Laboratories et al.*, decided on March 20, 1980 (80 Daily Journal DAR 782), the highest court in the State of California has accepted a doctrine which permits liability to be assessed against all manufacturers and distributors in an industry. Recovery is based upon each defendant's market share. The doctrine will be invoked when plaintiffs cannot prove the specific identity of a defendant who produced a product which caused injury if that product is produced in the same allegedly defective manner by all defendants. The *Sindell* case was a case brought against all manufacturers of the estrogen Diethylstilbestrol (DES). It is alleged by plaintiff that this drug, manufactured between 1947 and 1971, caused injuries which manifested themselves after a minimum latent period of 10 to 12 years. It has been alleged by plaintiff's attorneys (see National Women's Health Network Briefs) that the DES Task Force Summary Report (DHEW) Publication No. 79-1688 demonstrates the number of and extent of possible cases involving this particular product. The Task Force Report estimates that the incidence of clear cell adenocarcinoma will be between 1.4 per thousand and 1.4 per 10 thousand through age 24 among women exposed to DES in utero (DES Task Force Report page 4). It is believed that there are between 500,000 and 2,000,000 women who were exposed to DES nationwide (DES Task Force Report page 31). The DES Task Force Report (on page 33) also estimates that the incidence of adenosis among DES daughters varies greatly, running from 30 percent to 90 percent (apparently between 150,000 and 1,800,000 individuals). There are also disputes as to the extent of damages which ought to be available in cases of adenosis. There have, however, been two recoveries by "DES daughters" who contracted clear cell adenocarcinoma. In *Bichler* v. *Eli Lilly*, New York Supreme Court, July 16, 1979, plaintiff's verdict was $500,000. In *Needham* v. *White Laboratories*, Illinois August 27, 1979, plaintiff's verdict was in the sum of $800,000. The case of *Payton* v. *Abbott Laboratories*, 83 F.R.D. 382, 1979, U.S. District Court of Massachusetts, produced a conditional plaintiffs' class certification. The plaintiffs' initial showing of class was between 13,000 and 53,000 individuals.

The DES scenario recited above is but one area in which "market share" liability might be applied. The doctrine opens wide the door to plaintiffs' class actions against classes of defendants. It is actions such as these which can easily result in the insolvency of inadequately financed and supervised insurance mechanisms, especially if there is no insolvency mechanism. It is available to the plaintiff where the plaintiff is unable to provide identification of the specific defendant involved. It has application to any case where industry members produce products which may be defective and where identification of individual products is lost. It can be applied to such a variety of products as machine tools, sporting goods, asbestos, etc.

There are other potential expansions of product liability law, none of which would be alleviated in any manner by the risk retention groups. In the case of *Barker* v. *Lull*, 573 P.2d 443, 455, the court in a footnote stated, "In the instant case we have no occasion to determine whether a product which entails a substantial risk of harm may be found defective even if no safer alternative design is feasible." The question posed by the court is an omen. Ought a risk retention group, in its process of formation, consider that open question in its premium assessment as law or merely as a possibility? Implementation of that footnote would finally convert the tort system to a pure compensation system. Apply that footnote to football helmets, drugs, knives or machine tools and every injury could result in tort-size compensation.

One must also remember the decisions in product liability are often retroactive. The *Sindell* case cited above will impose liability on insureds and insurance companies for actions taken more than 20 years ago. Significantly, at that time, there was little indication that the actions taken by the defendants could result in injury or even if they resulted in injury, that they could result in a new legal doctrine of "market share" liability. Yet, the premiums assessed long ago must bear the burden of the recoveries paid today. In cases involving continuous exposures to drugs, chemicals, fumes, dusts, etc., the courts are now deciding how many years of insurance coverage may apply.

Federal establishment of an insurance mechanism which encourages companies to desert the commercial insurance market and established State regulation and furthermore rejects as an option an insolvency mechanism is courting disaster. It is doing so not only for the insureds but also for those people who will depend upon a solvent insurance mechanism for compensation. The Department of Commerce states in its Overview in support of the Risk Retention Act (page 1), "The overriding objective of the State insurance regulatory system is to ensure the solvency of all commercial insurers." It is important to recall that the assurance of solvency of insurers is for the benefit of injured parties and insureds.

Of special concern to the public, legislators and insurance regulators is the protection against insurers' insolvency. The risk retention group vehicle is proposed as a benefit for those insureds which are most difficult to price accurately and for whom high cost reflects high-risk activities. As indicated above, groups concentrated in single industries will be particularly susceptible to insolvencies. The Department of Commerce, in an earlier version of the Risk Retention Act, included an option which would have mandated for these insureds an insolvency mechanism to protect injured persons in the event of an insolvency of a group providing coverage for products losses. This mechanisms is one which exists in the commercial market today in the States. If an insurer becomes insolvent, other insurers, through the various guaranty funds and insolvency mechanisms, will assure that individuals who are injured by an insured's product are compensated to the extent of coverage ffered. The Department of Commerce has elected not to use this mechanism, eaving the claimants against such groups without protection.

Yet, this is an expense which clearly ought to be borne, for the benefit of onsumers. Under the Department of Commerce approach, companies which are the nost likely to become insolvent (high-risk, industry-concentrated, and difficult to rice), are the very ones which are not required to be covered by an insolvency fund.

The proposal is even premised on the idea that they will be providing coverage at ates lower than normal, yet relies upon their self-interest to assure that there will e no insolvencies. This is simply not realistic. Insurance companies also have the ame self-interest in continued survival and yet insolvencies do occur. When they ccur in the absence of an insolvency fund, persons who ought to be compensated or injuries they have sustained are the ones who will bear the ultimate burden nless the Federal Government provides funds at some later date. The Federal overnment may stand by when insurers organized under its auspices go under, eaving innocent injured victims to fend for themselves, or it may later be forced to ut up the funds which the groups should have been compelled to retain in the first lace.

The bill is totally inadequate insofar as it deals with group dissolution or member ithdrawal. Because there is no past history on groups, because the Department icks insurance experence and because there is no guidance in the legislation, each ithdrawal, dissolution or membership change will be an experiment in bureaucrat- power. What will happen to assets of the group on either dissolution or insolvency unspecified. What will be the priority of creditors is unstated. Protection of past nd future claimants in these bills is a particularly vexing problem (e.g. what appens to reserves and other assets of the group when one of its member's fees ises above 5 percent?) Insureds participating in funds will be trapped by the nsurance purchasing practices of the co-members. If one member with a 5 percent hare returns to the market, assuming assets and future liabilities can somehow be mited, what happens to the group?

The Department of Commerce, in the Overview (page 13), also stated that risk etention groups ought to be exempted from State reporting requirements imposed pon commercial insurers. It is true that these reporting requirements, in many nstances, are burdensome but it should be recalled that the Department of Com- erce has been instrumental in instituting additional reporting requirements for nsurance companies. The Department of Commerce might instead have spent its me in developing reasonable reporting requirements to be imposed upon insurers nd those involved in the field of product liability. The NAIC did develop a supple- ent to the insurance annual statement which the Department seems to feel is aluable, but the Department has not been heard in the States where counter- roductive reporting legislation has been promoted. To the extent that reporting equirements are imposed to make determinations concerning the field of product ability, it seems reasonable that all those involved, whether risk retention groups, nsurers or State captives, ought to respond.

The Department of Commerce (Overview page 13) says that the risk retention roups ought to be excused from participation in residual market mechanisms. The epartment said, without preemption, the groups "would be subject to compulsory nembership in any residual market mechanism, such as assigned risk pools, that night be formed in the product liability area."

It should be noted that insurance commissioners either now have or can seek egislative authority in the States to assure that insurance is provided in certain reas. Some States already have provisions under which the commissioner can equire that insurance companies provide essential insurance. The commissioners in nose States have not yet found that there exists any crisis in product liability nsurance which warrants the invocation of that authority. Nevertheless, a possible cenario is that if the many insureds were to leave the State insurance market for a ederally authorized insurance mechanism with lax regulation, there might develop n the State level an availability crisis which would lead to the invocation of esidual market authority. In such a case, it seems entirely inappropriate that the ery groups that would be creating the problem ought to be excused from participa- ion in the solution.

Other so-called burdens identified by the Department of Commerce (Overview age 10) include insurance commissioner discretion. It should be noted that the iscretion of the Secretary of Commerce under the Risk Retention Act is practically nlimited. Title III, Section 302 says, "The Secretary shall promulgate such rules nd regulations and take all other actions as may be necessary or appropriate to nplement this Act." Indeed, this is the broadest rulemaking and regulatory author- y imaginable. The Department of Commerce has identified as another impediment "rate and policy form regulation" on the State level. It is impossible to envisage the group operating without such regulation at any level. Where is the gain?

It would appear, therefore, that the regulations complained of at the State level are neither inappropriate nor excessive. Any lesser degree of regulation at a Federal level may lead to insolvencies with a Federal role.

CONCLUSION

The Department of Commerce, in its announcement of the release of the Risk Retention Act, has indicated it anticipates that, as a start-off, it will require some 15 to 20 employees to manage and supervise the risk retention groups. Clearly, the formation of a new Federal bureaucracy is in the offing. This is a step which ought not to be taken unless there is an absolute determination that it is necessary. For the reasons indicated, it is the position of the American Insurance Association that such a finding cannot be made.

Senator Packwood [presiding]. Thank you, Mr. Connolly. Mr. Jordan?

Mr. Jordan. Thank you, Mr. Chairman. I'm Donald L. Jordan, assistant vice president for the Alliance of American Insurers, a major national trade association of approximately 130 property and casualty insurance companies, both large and small.

We are appearing today also on behalf of the National Association of Mutual Insurance Companies, which represents some 1,200 small mutual insurers. Our respective member associations provide insurance and related services, including product liability, throughout the United States and the District of Columbia. We certainly appreciate the opportunity to appear before you today and ask that our statement be submitted for the record.

Senator Packwood. It will be made part of the record.

Mr. Jordan. Thank you.

I will only be briefly commenting on my statement. Then I'll have some oral comments to amplify what is already in the prepared text.

Senator Packwood. May I ask a question? Is the difference between you and the previous association that they are publicly held and you are not? You may be mutuals or some other form of ownership?

Mr. Jordan. That's partially true. Our membership includes both mutual and stock companies. I believe the prior associations are primarily stock.

Senator Packwood. Is that the only difference?

Mr. Jordan. I think historically our companies—I'll get into this in a minute—because historically our members grew up in an era where they were having trouble with insurance markets, and they formed some of the first captives, the very issue that we're talking about today.

As a matter of fact, one of our companies, Liberty Mutual, may be seen in some eyes as an early captive, a group of factory owners that got together early in the 1910-15 era to form an insurance company. So historically we do come from different directions.

Senator Packwood. Thank you.

Mr. Jordan. We want to make it clear to the Commerce Committee that the Alliance is in no way in opposition to the formation of risk-retention groups by small businesses. This is very important.

We are being cast in a position that we are blocking small businesses from forming these groups, and that is simply not true, Senator.

Our proviso is that as long as these groups are subject to time-tested, effective state regulation, that's fine with us. That's the way many of our companies in fact were formed.

We look at ourselves as going back to the lumbermen, pharmacists, factory owners, and kother groups who formed mutual insurance companies because they were having trouble finding what they wanted in the insurance marketplace at that time. That's the genesis of our association, so we are in consonance with the objectives of small business when they say, from time to time, that they're having problems with affordability of product liability insurance.

I want to switch my testimony now to some oral comments which I think may be helpful to the committee.

The Commerce Department testified earlier today and elsewhere that impediments exist, which is the very question you asked about, to forming statewide insurance associations, and that it was impossible to get around them.

Well, we have some information for you that I think you might find illuminating, and the Commerce Department may find it illuminating as well, on the number of risk groups that have been formed under the aegis of a State insurance regulation, contrary to Commerce's assertion that no groups have been formed. We count several dozen of them, and I'm going to submit that as part of my testimony today, because I made a list of them. I've done this on an ad hoc survey of my own. I'm sure that there are many more. If we had time, we could have found more for you, but I think you'll be very interested in what we have come up with.

First, let me read a letter that I received from Alexander & Alexander, which is a major brokerage firm, relative to the question I posed to them. They said their department runs a dozen major programs beyond the one that they sent to me, relating to product liability insurance that they set up for key industries, and they say they're in the process of developing quite a few more. That's Alexander & Alexander. I'd like to submit that.

Senator PACKWOOD. You want that inserted in the record?

Mr. JORDAN. If you would like to, sir.

Senator PACKWOOD. I'd be happy to.

[The following information was subsequently received for the record:]

ALEXANDER & ALEXANDER INC.,
New York, N.Y., March 17, 1980.

Re American Importers Association

DONALD JORDAN,
Assistant Vice President, Alliance of American Insurers,
Washington, D.C.

DEAR MR. JORDAN: Enclosed please find a copy of the American Importers Association brochure[1] covering their combined product/cargo coverage.

This is a highly sophisticated program which requires a considerable amount of underwriting expertise and the rates indicated are simply indicative of some of the rates being charged on the program.

I will not offer any quotations until we have seen properly completed applications and we are satisfied as to their content.

In addition, my department runs a dozen other major programs in various industries and we are in the process of developing quite a few more. The key to our success has been the unusual basis under which we define risk and our unique ability to defend risk on a basis not usually associated with the industry. We are not at a liberty to release brochures on other programs unless you have a client who is a member of one of those associations.

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[1] The brochure is in the committee files.

If we could be of further assistance, please don't hesitate to contact me.

Very truly yours,

Peter M. Polstein,
Vice President.

Mr. Jordan. That includes a brochure which comes from the American Importers Association, where Alexander & Alexander set up a product liability cargo insurance group plan for them.

We have also here a pamphlet from the Insurance Company of North America, MarketDyne Department, where they talk about safety groups that they've set up, and they list a whole passle full of safety groups that they've set up at the State level for various associations. Let me tell you what the safety group does.

They say these are commercial insurance programs for owner-managed or franchise businesses and nonprofit organizations. Programs are designed to offer fire, theft, liability—which would include product liability and workers' compensation insurance—and reduce the cost of losses. The safety group policy is individually tailored to meet the specific needs of the insurers.

Many businesses and trade associations endorse the safety group program for insurance on all of its members, and they provide important dividends if the groups have had good loss experience, contrary to what was said earlier today. These exist and they are functioning.

And here's a list of various associations which have formed captive insurance companies, either domestically or offshore, and they're all functional; they're alive and well, and we think there are a lot more of them out there. If we have time, we'll find them for you.

I'd like to submit this as well.

Senator Packwood. We'll put that all in the record.

Mr. Jordan. Thank you.

[The following information was subsequently received for the record:]

Trade Insurance Association Pools Formed

Paint and Varnish Association; Soil Engineers; Industrial Gringind Wheel Manufacturers; Pharmaceutical Manufacturers; Chemical Manufacturers; Medical Device Manufacturers; Automobile Manufacturers (Automobile Insurance Company, Ltd); Machine Tool Builders (Only one company participates); Hospitals (MSJ Ins. Co. is Colorado Captive); Doctors (Missouri Doctors—MOMEDICO); Portland Assurance Ltd. (Cement Trade Assn.); Caterpillar Tractor Dealers (AIC Holds Co.); Oil Jobbers Assn.; National Welding Supply Assn. (WESCAP) (Factory Mutual Insurance System and Liberty Mutual were essent); Continental Skateboard Assn. (Member Parks); Attorneys Liability Assurance Society Ltd. (35 law firms) Also Bar Assurance and Reinsurance Ltd. (21 NY law firms); Retail Tire Dealers (Bermin Ltd.); N.A. Elevator Contractors (NAEC I.C. Ltd.); Texas Growers Association (Texas Citrus and Vegetable Insurance Exchange).

Oil Refiners (APRAICO) 4 refiners; Wholesale Druggist Assn. (Pharmaceutical Ins. Ltd.); Cement Mfgrs. (Portland Assurance Ltd.); Conveyor and Foundry Machinery (NAMIC) (12 Machinery Mfgrs.); Association of Bituminous Contractors (Coal Contractors Ins. Ltd.); Group of Light Manufacturers and Processors; Group of Iron and Steel Producer (APIECO); Mobil Home and PREFAB Mfgrs. Group; Teaching Hospitals (Medical Centre Ins. Co. Ltd.); Group Podiatrists (Professional Protection Ltd.); Michigan Licensed Beverage Dealers Assn. (MLBA I.C. Ltd.); American Tuna Boat Assn. (Seafamer Ins. Co.).

Scaffold Industry Assn. (SIA Ins. Co. Ltd); 11 Farm Equipment Mfgrs. (Farm Co.); Chemical Specialists Mfg. Assn. (ChemSpee); Synthetic and Organic Chemical

Mfgrs.; Rent-A-Car Licensees (AIRIC Ltd.); Dog Track Operators (AGTOA I.C.); Agricultural Chemical Manufacturers (Agrichem I.C.); American Frozen Food Institute; American Grocers Assn.; American Ladder Institute (Safe Step Reins. Co.); American Importers Association; Machine Dealers National Association.

Mr. Jordan. Finally, just two other items here. One, it's very confusing to try to figure out what is available, what isn't available, in the insurance market, so we've put together this description of the various alternatives right now that exist for companies that want to insure, all the way from buying an individual insurance policy to totally self-insuring and all the steps in between.

I'd like to submit that also for the record.

Senator Packwood. It will be done.

[The following information was subsequently received for the record:]

Existing Alternatives Provide Ample Opportunities for Small Business To Manage Their Product Liability Exposure

(All the alternatives listed below are already available under our existing system of state regulation).

1. Purchase of an Individual Insurance Policy.

(a) Types of Policies: Comprehensive General Liability Policy; Commercial Multi Peril Policy; Product Liability and Completed Operations Policy.

(b) Methods of Rating: Guaranteed Cost; Guaranteed Cost with Dividends; Experience Rating (with premiums in excess of 1,000 to 2,500 annually); Retrospective Rating to be eligible policy should develop 200,000 in estimated losses over a three-year period.

2. Purchase of Individual Policy as Part of an Existing Safety Group (state or national groups): Coverage provided is subject to possible experience credits based on aggragate group losses.

3. Safety Group Policy with Deductibles: Insurer pays all claims above deductible; Insurer may service deductible claims for a fee.

4. Group Self Retention Plan: Relies on the use of a "fronting company"; Techniques similar in part to cash flow programs used by large self insured businesses where the group gets the benefits of investment income on reserves set aside; May involve deductibes, with experience rating formulas and excess coverage.

5. Group Self Retention Plan with a Rented Captive Company: Group pays for use of an established captive with existing fronting arrangements as in No. 5.

6. Group Self Retention Plan Organized and Funded Through a Captive Insurance Company: Captive typically uses fronting company; Captive can be state chartered or offshore; Commercial insurance market provides excess and aggregate stop loss coverage; Captive can be formed as—Stock (participating stock); Mutual; Reciprocal; 509 c_3 Trust.

7. The final option is to be totally self insured which implies a formal risk management program—typically provided with excess/umbrella coverage.

Mr. Jordan. This has gotten to be such a big issue. Now, here's a company, AMR International. They had a seminar in New York City just a couple of weeks ago on structuring association and multiowner capital insurance companies. They're not waiting for the Commerce Department to come out with their bill; this is going on right now. People are forming captive insurance companies, for product liability, and others risks.

I don't know if you want to submit the entire seminar booklet for the record, but I wanted you to see it.

Senator Packwood. We'll put that in the record also, or if you'll submit it——

Mr. Jordan. I don't think you need to have the whole thing in the record, but I just want you to be aware that I have it.

Senator Packwood. Thank you, we will keep it on file with the committee.

Mr. **Jordan**. Let me conclude now. We recognize that the market for insurance products and services is flexibile, competitive, and we believe increasingly more responsive to the needs of small businesses. We believe that many business groups have availed themselves of these conditions to form groups under our existing State regulatory framework.

Finally, the Risk Retention Act itself, we believe, is replete with inconsistencies and is an unwarranted intrusion of the Federal Government into the regulation of our industry. In an age of deregulation, we believe this type of proposal calls for more regulation.

We call on the committee, rather than to take action to pass this measure, to go back and ask that a more thorough review be conducted to look at the existing alternatives that are out there right now and what these other successful groups have done to find group insurance coverage on their own.

Thank you very much.

Senator **Packwood**. Thank you. Good job.

[The statement follows:]

Statement of Donald L. Jordan, Assistant Vice President, Alliance of American Insurers

I am Donald L. Jordan, Assistant Vice President for the Alliance of American Insurers, a major national trade association of property and casualty insurance companies. Our member insurers provide insurance and related services including product liability coverage within all 50 states and the District of Columbia.

We appreciate the opportunity to reappear before the Committee to testify on proposed remedies to deal with products liability problems. In that regard, our statement today is organized to address the following issues:

Major inconsistencies in the Risk Retention Act which proponents have yet to resolve; A fairy tale about risk retention groups; Comments on the Model Uniform Product Liability Act; Actions already taken or underway to help resolve product liability problems; Selected listing or organizations who have established; Group insurance programs; Association captives—focus on problems in formation.

We wish to establish to the Committee that the Alliance is not in opposition to the formation of risk retention groups, per se as long as these groups are subject to effective state regulation.

We do not support the Risk Retention Act because we are convinced it is not necessary and because it is predicated on a false premise—that existing state regulation constitutes an effective barrier to the formation of insurance groups. Further, many insurance mechanisms are readily available not at the state level to facilitate the formation of self insured groups.

The Alliance is very encouraged by the work of the Commerce Department in its development of a Model Uniform Law on Product Liability for state implementation. (Our comments appear later in this statement.)

Let's look at some of the major inconsistencies surrounding the federal chartering of group captive insurers.

Inconsistency No. 1.—It is contended that state regulation of insurance has inhibited or in some cases prohibited the formation of insurance groups

In his recent testimony before the House, C. L. Haslam, General Counsel of the Department of Commerce testified that "the rationale for federal action is the inability of individual states to collectively encourage product liability group self insurance * * * Colorado enacted a statute in 1972 to encourage group captive insurance companies. Despite this permissive legislation, not one group captive has been formed in that state." The Department of Commerce went on further to say in its background paper on the Risk Retention Act that "(state insurance) regulations create insurmountable barriers to the (formation of self insured) groups * * * "(they) have had the practical effect of preventing product sellers located in different states from forming self insured groups."

Although the Department of Commerce is convinced no group captives have been formed in Colorado, the Colorado Insurance Department advises that at least 30 captives have already been formed in the state and of these eight are group captives, some of which have been in operation for several years. Further, an association captive in Colorado does not need to be licensed in all other states where members of the association group have places of business or loss exposures. The captive can either (1) use fronting arrangements using existing commercial insurance carriers or, (2) it can provide coverage throughout the U.S. to all its group members as long as the group captives business is conducted within the State of Colorado. Hence, there is no requirement for multi-state licensing and we take issue with the Department of Commerce on its contention that this is an effective prohibition to the formation of state chartered captives.

Attached to our statement is a selected listing of industrial and commercial organizations that have already established group insurance programs. It is by no means exhaustive. Almost all of these groups have been established under the auspices of state insurance regulation, some as domestic captives and some as state sponsored safety groups which are underwritten by commercial insurers. For example, Employers of Wausau, Kemper, Sentry, Firemans Fund and INA among others provide group coverage for "Safety Groups." Such group programs benefit members through healthy dividends from good experience while establishing effective programs for loss prevention and safety. Commercial insurers have established many such programs to assist in organizing and servicing the group insurance needs of trade associations, franchise operations and other commercial or institutional groups.

To suggest that state regulation has been an effective barrier to the formation of insurance groups simply disregards the large number of groups already formed and functioning for the benefit of their members. Other alternatives to establishing group plans at the state level include the formation of mutuals, reciprocals, off shore captives and stock companies. Given these many and existing alternatives, the federal chartering of captives is totally unwarranted.

Inconsistency No. 2.—Although many business groups are vocally opposed to any form of federal intervention in their affairs, they apparently don't have similar concerns regarding the potential for such widespread involvement from the sweeping powers granted to the Department of Commerce under the Risk Retention Act.

We believe that small companies who form risk retention groups would be subject to extensive and direct federal review and involvement in their financial conditions and operations. Its probable that such involvement would not be limited only to the operations of the risk retention groups but would directly affect the management of small businesses themselves. Were the Department of Commerce to utilize its full regulatory authority as granted under the Risk Retention Act, it would not be difficult to conceive of widespread federal intervention through the operation of these federally chartered captives. Such involvement might take the form of any, if not all of the following actions:

Review of organization structure, proposed operating plans vendor contracts, etc., for a group program.

Evaluation of management competence and expertise.

Audits of financial condition and operations both of captives and member companies.

Inspection and investigation of loss prevention plans and programs. (Group and individual members)

Review and/or validation of claim experience for the prior five years. (Group and individual members)

Review of tax and eligibility criteria established by each risk retention group (the Departments of Commerce, Justice and Treasury would have to independently review each application for formation of specific risk retention groups).

Review evaluation and/or involvement in product design standards and quality control procedures (particularly if claims experience threatens Group solvency).

Review of claims handling practices and consumer complaint procedures.

Review of investment posture, adequacy of capital/surplus relative to aggregate group loss exposure, outstanding claims and claims reserves.

Possible imposition of federal controls over group operations and financial conditions where investment, solvency, claims handling practices, etc., come into question.

Review of assessment practices. Are premiums being charged by the federal captive to its members adequate, equitable, and not unfairly discriminatory.

Frankly, we think its ironic that the same small businesses who voice bitter concerns over federal involvement regarding the impact of the Occupational Safety and Health Inspection Act have no significant misgivings when corallay authority for such widespread intervention is granted to a different federal agency.

Finally, we note the President has just asked the heads of his independent regulatory agencies to "minimize the regulatory burden on small business" while improving the "efficiency and sensativity of the regulatory process" (message from the White House to heads of independent regulatory agencies 11/16/79). We question then why the Administration has agreed to support the Risk Retention Act which itself grants sweeping yet indeterminate regulatory authority (direct and indirect) over federally chartered captives (and their members) by the Secretary of Commerce.

Inconsistency No. 3.—The Department of Commerce believes that risk retention groups can be effectively managed in the public interest through self regulation and the pressure of "market forces".

The General Counsel of the Department of Commerce, C. S. Haslam, set forth in his House statement, the initial scope of regulatory involvement anticipated. The Department of Commerce stated "the secretary is directed by the Act to look at various factors including the group's assets, (adequacy of) its management (expertise), its reserves, and its loss prevention program (as well as the amount of risk it will or should accept, claims handling ability, etc)". "Approved groups must meet minimum financial and management standards (Section 101 and 102). Also they will have to maintain proper reserves (Section 103). These requirements will assure that the groups will be able to meet covered claims brought against members." At another point in his testimony, Mr. Haslam stated that "approved groups would be subject to more stringent requirements (than commercial insurers) in some cases." We do not wish to take his remarks out of context, but we do believe that they point out a basic inconsistency. On one hand, the Department of Commerce has said that the groups would essentially be self regulated by the marketplace and require very little oversight from the government. However, the language in the Act gives the Secretary of Commerce an extensive degree of regulatory authority that goes even beyond that provided to state insurance departments. This very broad regulatory authority set forth for the Commerce secretary could be even further embellished through regulatory interpretation.

If the Department sincerely believes that the market will be the final regulator of these groups, why does it require such sweeping regulatory authority be written into the law. If the Department sincerely believes that these groups will not have solvency and/or financial problems (under a system relying principally on regulatory oversight by the marketplace) then one must ask why the Commerce Department initially proposed a federal guarantee fund to backstop the risk retention program.

In its background paper, the Department of Commerce states that "the self interest of each group's members in assuring its proper management and solvency as well as the strong pressure placed on the group by its excess insurer and reinsurer also substitute for regulation (underlying added for emphasis). However, rather than having group self interest substitute for regulation, we believe the self interest of many risk groups would be structure programs to assure reduced insurance expenses notwithstanding their extensive aggregate loss exposure.

In making this point, we are not suggesting that risk retention groups, if they are effectively regulated, can not function. We are suggesting that effective regulation such as that embodied in existing state programs is essential. We believe that many in the business sector would not support the adoption of federal chartering were the essential regulatory authorities sufficiently spelled out in that legislation.

Inconsistency No. 4.—The Commerce Department believes that federally chartered risk retention groups will "reduce insurance costs * * * particularly (for) small firms which have had good claims experience."[1] The expectation here is that members of these groups may have been improperly rated and that by banding together to form their own specialized insurance organization, they will be able to automatically effect significant savings in annual outlays to finance their aggregate product liability loss exposures.

Let's take a hard look at the capital required to organize and operate such a "specialized insurance company." Its not as simple as it may seem at first blush. Before any risk retention group is established, it will, of course, need to determine whether the requisite homogeneity of interest exists between members for successful operation (i.e., between small and large risks, those in only marginally comparable product lines, etc). The following suggests some, but not all, of the many costs which would need to be incurred simply to establish and operate a risk retention group as envisioned by the Department of Commerce.

Initial start-up costs for a Federal captive

Requisite feasibility study to determine if a group captive can, in fact, succeed. The cost of such a study often runs at least $15,000, and could be much greater.

Initial fact gathering to establish rating base, safety programs, eligibility, etc.

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[1] Background paper on the Risk Retention Act prepared by the Department of Commerce.

Initial contribution of capital and surplus to meet requirements of the Department of Commerce and establish reserves.

Funding of a letter of credit if reinsurance or excess insurance is to be purchased.

Initial organizational costs, attorney fees, cost of incorporation, establishing eligibility requirements, etc.

Annual costs anticipated to operate a federally chartered risk retention group

Payment of individual claims and claim adjustment expenses under any deductibles built into the group plan for its members.

Annual premium assessments to members to offset claims, claims adjustment costs and unreported claims that have occurred and to build claim reserves.

Incremental contributions to capital and surplus during formative years to offset immediate group loss exposure (under the DOC Act no restrospective assessments are allowed).

Ongoing management and operating cost for staff, space, clerical support, utilities, etc., as well as fringe benefits, travel, meeting expenses, etc.

Pro-rata reimbursements to the Department of Commerce for the maintenance of its regulatory oversight program since the Act is designed to be self supporting with risk retention groups fees covering all federal administrative costs.

Purchase of excess insurance and reinsurance (assuming it is available).

Accounting, recordkeeping, printing, reporting and audit costs both for internal and external reporting to Commerce and/or other government agencies (i.e. Consumer Product Safety Commission, Federal Trade Commission).

Payment of state premium taxes on annual assessments.

The cost of contributing to state guarantee programs (although it is unknown to what extent states would allow such groups to participate in their guarantee programs since only limited regulatory oversight is anticipated by the Department of Commerce.

Expenses for establishing and maintaining loss prevention and safety programs, setting quality control and design standards, auditing risk group members to assure compliance, etc.

Payment of state and federal taxes on investment income earned. Etc., etc., etc.

In order to build up sufficient reserves during the early years, it is quite possible that member assessments could easily be in excess of current rates charged by insurers in todays open market. One has only to look at the history of medical malpractice mutuals to see some of the difficulties they have experienced in establishing group insurance facilities (massive increases in rates have been required in the last year or two to offset spiraling losses).

To assume that the cost for insurance protection for members of each group would be automatically decreased simply by the formation of a federally chartered facility could prove an expensive and painful lesson to many small businesses.

The involvement/support of small businesses in forming risk retention groups can not be seen as a temporary expedient. Such a decision requires a long term commitment of capital, management resources by all who participate.

Inconsistency No. 5.—It is contended by proponents of the Risk Retention Act that evidence is overwhelming that proposed benefits (of the Act) outweigh any possible negative consequences.

After many months of study, the Department of Commerce has become convinced in fact that the Risk Retention Act, if passed, would in itself be singularly effective in accomplishing all of the following objectives. That it would be expected to:

1. Stabilize product liability insurance markets
2. Make insurance markets more competitive
3. Make the insurance rates charged to individual risks more accurately reflect loss exposure (whether or not they participate in federal chartering!)
4. Lower insurance costs for small businesses
5. Insure the prompt payment of legally valid claims
6. Stem the flow of capital to offshore captive insurers
7. Increase the probability that product liability claimants can enforce their judgments

We are convinced that the proposed benefits set forth by the Department of Commerce simply bear no relationship to reality in terms of how many groups might actually be formed. The fundamental underlying rationale for achieving all the objectives listed above would be predicated on the widespread formation of risk retention groups chartered at the federal level. This assumption is controlling, yet it does not hold up to even casual scrutiny.

The Department of Commerce, in fact, has testified before the House that they have no idea how many groups might be formed if the Risk Retention Act were to become law (testimony of General Counsel C. S. Haslam before the House 10/25/79). To our knowledge, not one business organization has yet to make a firm commitment to establish even one risk retention group (although many have advocated general support for limited forms of self insurance).

In particular, we noted with interest the testimony of the National Federation of Independent Businesses before the House which stated that the typical small business who might benefit from the Risk Retention Act was itself the prisoner of limited cash flow and capacity to pass through cost increases. In fact, they concluded that "a small firm would be inclined not to participate in risk retention groups at the federal level if similar protection at similar costs can be obtained through conventional sources" * * * (since) "the small firms capital still remains tied up when it is usually badly needed for other purposes." (We make the point elsewhere in our statement that many viable alternatives to establish insurance groups now exist and are actively being used at the state level.)

Further, the NFIB in its testimony of 10/26/79 brought up the distinct possibility that no risk retention groups might be needed or organized if the federal Risk Retention Act were passed. We find the logic of their conclusion on page five of their statement of particular interest: "If none (that is no federally chartered risk retention groups) are needed, then success has been achieved at no more expense than the cost of conducting hearings and printing reports." They go on to say that "The greatest measure of success of Title 1 in a sense would be the lack of use of the title to establish risk retention groups." These remarks frankly, suggest to us only minimal use of federal chartering by small business.

Finally, we note that although the Department of Commerce has testified it has no idea how many risk retention groups might be formed if the Act were made law, it has already made a rough estimate of the number of staff members who would be required to organize and direct this regulatory oversight program. We believe they are putting the cart before the horse.

THIS IS A FAIRY TALE ABOUT THE RISK RETENTION ACT—OR IS IT?

It is not difficult to conjure up the following scenario which we believe is not only possible but may even be probable if the federal risk retention act becomes the law of the land. Although proponents of the act are well intended, we believe its result will be increased federal involvement in and regulation over the private sector, and frankly, the prospect gives us nightmares.

THE FAIRY TALE

Despite the fact that many business groups have endorsed self insurance proposals in principle, only a handfull actually establish formal risk retention groups and become federally chartered.

Because only a small number of small business actually establish risk retention groups the problem has no significant or lasting impact on insurance markets, on competition, or rates, or on capital flows out of the United States.

In its initial stages, the Department of Commerce relies heavily on external "market forces" to provide regulatory oversight.

Due to the minimum level of regulation initially adopted by the Department of Commerce, some risk retention groups choose to limit capital contributions to reduce insurance expenses. Consequently, some of the groups are only minimally funded to offset their aggregate product liability loss exposure (from contributions and annual assessments since their objective is to keep their insurance costs as low as possible).

Because of insufficient funding and capital reserves, some groups finds it difficult if not impossible to obtain excess insurance and reinsurance. Similarly, state guarantee funds choose not to accept risk retention groups for fear they are underfunded and ineffectively regulated.

As time goes on, claim reserves prove to be inadequate to meet incurred losses in some of the groups insurance programs and those members which have superior loss experience attempt to leave and return to the commerical insurance marketplace, leaving a concentration of poor risks and inadequately funded liabilities.

The few risk retention groups which are formed must absorb costs incurred by the Department of Commerce for establishing a regulatory office and program (on a pr rata basis—with say only ten professionals initially in the DOC Risk Retention Program office supported by expenditures for clerical staff fringe benefits, office space, travel, operating costs, audit expenditures, etc., total expenses would in al probability greatly exceed $500,000 annually.)[1]

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[1] If one assumes the cost of setting up such a program to be at least $500,000 annually by th Department of Commerce with say 10 groups formed, the pro rata cost to each risk retentio group would be in excess of $50,000 annually.

The Department of Commerce becomes concerned over time because its previously funded resources and staff are underutilized with few risk retention groups actually formed. Therefore, Commerce seeks legislation to enlarge their role in regulating risk retention programs so that they will now apply to other lines of commercial insurance such as workers' compensation, professional liability, group life and health, etc.

The Department of Justice raises questions concerning the eligibility requirements established by a risk retention group which effectively keeps out all the bad risks who have the most acute exposure to product liability losses.

A few risk retention groups become financially shakey and/or insolvent and petition is sent by the Department of Commerce to the Congress for supplemental funding to assist in paying outstanding claims and liabilities.

The Department of Commerce recognizes too late that it laxness in regulating the risk retention groups was a mistake. Stung by GAO report critical of its operations, Commerce shifts dramatically and becomes an activist regulator by getting directly and actively involved in risk retention group management, operations, standard setting, reserve practices, recordkeeping, loss control programs, audits, etc.

Some may say that none of the above events could occur because the need for federally chartered risk retention groups has already been so well documented, because federal regulatory responsibilities are already clearly defined and understood in the risk retention act and finally, because federal regulatory programs in general are today being effectively managed such that their impact on the private sector is always in the public interest. Besides doing something now may be better than letting the pendulum of market dynamics swing its natural course.

DEPARTMENT OF COMMERCE—MODEL UNIFORM PRODUCT LIABILITY ACT

The Alliance has made an initial review, with great interest, of the final draft of the Department of Commerce Model Uniform Product Liability Act. At the outset, we would like to sincerely commend Professor Victor Schwartz and the staff of the Department of Commerce Product Liability Task Force for their extension efforts in producing this final document. Even a cursory review of the model act makes it obvious that exhaustive thought and effort was put into their attempt to produce a model act which would provide a reasonable balance among the viewpoints of all interested parties and still achieve the goal of producing uniformity and stability in the law of product liability.

We are especially gratified by their willingness to be openminded and receive the viewpoints of all interested parties. Their sincere effort in attempting to balance various interests has produced a document which should benefit the public as a whole.

We feel that the model law as drafted now represents a substantial improvement over the initial draft. It restores balance between the right of those persons injured in produce related incidents to receive just compensation, and the right of manufacturers and products sellers to have a certain degree of predictability with respect to potential liability arising from the use of their product. It also provides a possible basis for stabilizing insurance costs by providing a mechnanism whereby future loss exposure can be more reasonable predicated.

We are pleased that the Administration has adopted a position of developing a document designed for implementation by the individual states, rather than suggesting the enactment at the federal level.

It is true that instant uniformity could be achieved by a federal enactment. However, tort law, traditionally, has been a matter of concern for the individual states, and we feel that the states should have the opportunity to clarifying the tort law in the product liability area before serious consideration is given to federal enactment.

The fact that a number of states have taken steps in this direction during recent legislative sessions, is a definite indication of their concern over the problems in the product liability area, and their willingness to take appropriate steps to attempt to alleviate those problems.

The Act sets forth six criteria which were utilized in evaluating the provisions of the Model Act. These were:

1. To insure the persons injured by unreasonably unsafe products receive reasonable compensation for their injuries;

2. To insure the availability of affordable product liability insurance with adequate coverage to produce sellers that engage in reasonably safe manufacturing practices;

3. To place incentives for loss prevention on the party or parties who are best able to accomplish that goal;

4. To expedite the reparations process from the time of injury to the time the claim is paid;

5. To minimize the sum of accident costs, prevention costs and transaction costs;

6. To use language that is comparatively clear and concise.

We feel that these criteria thoughtfully framed and point to excellent goals. They should provide the framework upon which any legislation designed to clarify the law of product liability must be built. We subscribe to these criteria, and would work for their implementation with respect to any type of product liability legislation which might be introduced in the various states.

Our initial reaction is that the combination of tort reforms as proposed in the model bill would undoubtedly reduce product liability losses in the future to a substantial degree; and, more importantly, losses would be more predicatable and less open-ended which would provide stability in the insurance industry to assist in property pricing and underwriting product risks.

As we've indicated our initial general impression of the Model Act is cautiously favorable. We have not had time enough to prepare a detailed critical analysis which a far reaching proposal such as this merits. The Legal Committee of the Alliance is presently undertaking such a critical section by section analysis, and it is hoped that this will be completed within the next few weeks. Until this analysis is completed, therefore, we are not in a position to make a final determination with respect to the Act as a whole.

However, we do feel that the proposal does contain a number of general concepts that could lead to meaningful clarification of the law in the Product Liability area, if properly implemented. A number of these concepts have been previously endorsed by the Alliance and have been supported by us as part of a program of legislative clarification of the law of Product Liability at the state level.

These include a Statute of Repose, defenses based on the state of the Art, compliance with governmental or administrative standards, alterations by thirds persons, misuse of the product by the claimant, reduction of damages based on the plaintiffs comparative negligence, consideration of collateral sources, arbitration of small claims, limitation on recovery for pain and suffering and the standards to be applied in the awarding of punitive damages.

We would like to comment, specifically, on two changes in the final draft which are different from those which appeared in the original draft and which we feel are desirable.

Section 104 of the Final Draft provides that a product may be defective if it i "unreasonably unsafe" in construction, design, because of inadequate warnings, o because it did not conform to the seller's express warranties. With respect t products that are defectively manufactured or do not comply with the seller' express warranties, the manufacturer would be held strictly liable. In design i warning cases, the traditional negligence principles would apply, with the cour taking into consideration various factors which are set forth in the Model Law. W feel that removing design defects and failure to warn from the principal of stric liability is commendable. We agree with the rationale expressed in the analysi contained in the Model bill which states that "the application of uncertain stric liability principals in the area of design and duty to warn places the whole produc line at risk; therefore, a firmer liability foundation is needed. In terms of creatin incentive for loss prevention, the approach of applying strict liability principals t design and duty to warn cases represents an "overkill"; a fault system will provid the needed incentive.

Under the original draft of the Model Law, there was a provision which woul have allowed wrongful death claim to have been brought against the decease worker's employer, if such a claim was otherwise barred by the Statute of Repos and if it could be shown that an unsafe work place caused the death. A provision o this type runs contrary to the whole concept of worker's compensation laws whic makes recourse under them the exclusive remedy against the employer withou regard to fault.

This provision has been deleted from the final draft, thus preserving the exclusiv remedy doctrine and the integrity of the worker's compensation system.

In summary, therefore, we wish again to commend the sincere efforts of all wh were involved in the preparation of the Model Uniform Products Liability Ac While we are not, at this time, able to take a definitive position with respect to th Uniform Act as a whole, we feel that it may be a useful first step in providing mechanism for the clarification of the law of Product Liability with a view properly balancing the right of an injured product user to receive just compensati with the right of a manufacturer or seller of products to be able to reasonab predict, with some degree of accuracy, his potential liability.

We appreciate this opportunity to comment upon the Model Uniform Products Liability Act, and if appropriate, will furnish the Committee with any additional comments we may have.

ACTIONS UNDERWAY TO RESOLVE PRODUCT LIABILITY PROBLEMS

Since the mid 1970s when the product liability issue first came to national attention, a great many actions have been initiated to come to grips with related problems and speed in their resolution. To provide important perspective to the Subcommittee in deciding on possible future actions, we thought it would be useful to catalogue what's already occured as well as those actions that are going on at the present time. Further, we wish to point out to the Committee that throughout the past several years, several proposals to establish federal insurance related programs or incentives have been found to be either unworkable and unnecessary or not in the public interest and hence, have not been supported by the Congress:

The first major effort to come to grips with the problem of product liability was the formation of the Interagency Task Force on Products Liability which produced a great volume of information including three separate reports on the legal, insurance and manufacturing aspects by outside contractors. In support of this effort by the Administration, the Insurance Services Office and 23 participating companies conducted a massive closed claim survey of product liability at their own expense and the results were made available to all interested parties. Further, many business groups have also independently surveyed their members to determine particular product liability problems.

Beyond the above, there have been multiple congressional and state hearings as well and much literature has been developed on the products problem from legal scholars, product manufacturers and others. Finally, similar efforts to gather information and resolve issues have been launched in several foreign countries where product liability problems are also emerging (most notably in the European Economic Community).

These efforts to identify the nature and causes of the problem have led to great many actions to assist in its resolution:

Proposals to revise state tort laws have been passed to date in some 22 states.

Insurers under the guidance of state insurance departments have set up Market Assistance Programs to assist in providing coverage to risks who were exeriencing problems in obtaining affordable coverage.

Its been contended that a great deal more information has been necessary to improve the accuracy of product liability ratemaking procedures and to gain a better understanding of products liability insurance markets and trends in claims experience. Therefore:

The Insurance Services Office established a new type of statistical plan for commercial liability risks which separately identifies product liability experience by product group. Information is being provided under this plan which will assist in the development of more accurate product liability rates in the future.

A supplement to the Annual Statement filed by all insurers to identify aggregate information on products underwriting experience has been initiated by the National Association of Insurance Commissioners.

Also a number of states have recently initiated special reporting requirements both at the state and national level to develop an information base to assist in spotting trends and pinpointing insurance problems.

Finally, insurers themselves have expanded their underwriting process significantly since the mid 1970's for product liability risks. Underwriters have a great deal more information available today to evaluate the nature and scope of product liability exposures than was heretofore the case.

Many businesses and trade groups have independently reevaluated their own product design and manufacturing procedures in light of their ever increasing exposure to losses. We believe this has undoubtedly led to more exphasis on product safety and loss prevention by product manufacturers.

The insurance marketplace has also undergone a significant transformation since the mid-70's to meet changing customer demands. The growth of captive insurers both offshore and in Colorado has been impressive covering not only individual risks but association groups as well. A free trade zone has been established in New York to deal with special risks and placement problems while Insurance Exchanges that function as Lloyds type facilities are being readied in New York, Illinois and Florida providing new approaches to underwriting large and difficult risks.

A signifiant number of "Safety Groups" have been established by trade association and other organizations to provide affordable insurance coverage and loss prevention assistance to their members.

Finally, the market for product liability insurance has stablized since the mid 70s and has been energized by badly needed injections of underwriting capital. The results—the market for most product liability insurance risks is quite competitive and rates have leveled off or dropped. The property casualty insurance industry has experienced capital contributions from many different sources (most notable the life insurance industry, Allstate and others) while many traditional insurers have set up new departments to handle special commercial risks.

In retrospect, a great deal has occurred since the mid 1970s that has had a direct bearing on the product liability insurance marketplace. It is also true that problems of affordability still affect certain sectors of our economy. However, prior to launching on any new federal program, we believe it is essential to understand how dynamics of the insurance market are working today and that alternatives are now available to groups who seek limited self insurance under our existing system of state regulation.

Association Captive Insurance Companies—Potentials and Problems

(Bernard M. Brown, Risk Management—December 1976)

(Excerpts highlighting real limitations on the feasibility of establishing group captives)

Corporations, institutions and individuals unable to obtain stable, adequate and reasonably priced property and liability insurance coverage are turning with increasing frequency to association-owned or sponsored insurance companies * * *.

Oil Companies, public utilities, engineering and testing firms, contractors, printers, paint manufacturers and banks are examples of industries and businesses which have formed association captive insurers because of the advantages and potentials which the risk funding vehicle provides its members. Sometimes insurmountable problems are encountered in attempting to establish an association captive * * *.

The term "association captive" is used to mean a company owned by the participants themselves or by a formal group or association to which the participants belong * * *.

Even though it is generally easier to form a captive offshore and the capitalization requirements are lower, *a growing number of association captives have opted to from domestic captives* * * *. (emphasis added)

PROBLEMS OF ASSOCIATION CAPTIVES

As with most risk sharing plans, there are certain problems which are often encountered in establishing or administering an association captive. The two most important are: (1) gaining a consensus among the participants as to the goals and strategy of the association captive; and (2) gaining the initial financial support for the captive assuming that the goals and strategy agreed upon, A major strategy decision which must be made by the members is whether the proposed captive should compete with, replace, or complement the existing market which currently underwrites association members. Most captives are formed in an atmosphere of crisis, brought about by skyrocketing insurance costs and shrinking underwriting capacity.

This, in turn, usually implies that a new captive will first attempt to replace current capacity and then complement existing markets in order to increase capacity * * *.

Another strategy decision faced by an association captive is how to address multiple facets of what appears to be a common problem. For example, most associations are made up of both large and small members. This, in turn, usually implies that the larger members are having one set of problems (the unavailability of high limits of liability coverage), while the small members have another (the unavailability or prohibitive cost of low level limits of liability protection). Unless a consensus can be reached among the members as to the immediate goals of the association captive, the idea may be dropped or, more likely, a splinter group, e.g., all large members, may join together and form a captive which attacks only their own common problems * * *.

Directly related to the problem of gaining a consensus as to the goals and strategies is the one of obtaining the necessary financial support from the association membership. For example, some members may not be happy with the coverages to be provided or the rates contemplated by the captive, in which case it is not likely that the dissident members will pay in sufficient capital necessary to help establish the company * * *.

As another illustration, members of an association may be unwilling to fund the captive because the capital cost is too high in relation to the perceived benefits offered. Some members may take a short-term point-of-view and reason that, based on their own individual experience, they can continue to receive more money back from losses than they pay out in premiums. Such shortsightedness means that it is necessary to educate the membership to take a longer term perspective, particularly with regard to the premise stated earlier that the commercial insurance market eventually will receive back its losses and expenses, as well as earn an underwriting and investment profit. Or else, if the market sustains continued underwriting losses, or believes it will, it will discontinue offering insurance protection * * *.

A practical consideration to be made is the question of how the maintain support among the members of a captive, particularly in the first few years of operation when it is so important that the captive is strong financially * * *.

Pre-funding or post-funding of losses is another issue which must be resolved by association members. Pre-funding refers to the traditional practice of commercial insurers where a premium is charged, either in advance, quarterly, or monthly, which is enough to cover contemplated losses. Most captives should also follow this practice, particularly in the early years, so as to assure the financial soundness of the company * * * "post-loss funding * * * is fraught with danger and should only be used if all else fails."

The problem with post-funding is that members may not be willing to pay in premiums after a loss occurs, *especially if the members suspect that the captive will not survive in the future.* Thus, while post-loss funding is a distinct possibility to consider when establishing an association captive, it is fraught with danger and should only be used if all else fails and there is a strong moral and legal commitment by the members to the captive company * * * (emphasis added).

One very practical problem encountered during the course of studying whether or not an association captive is feasible, is the one of obtaining accurate and detailed information as to past losses, premiums and other pertinent items. It is often necessary to develop a detailed questionnaire which must be filled out by association members. Further, there is no guarantee that the information obtained is accurate; *it may be in the best interest of association members to understate losses and premiums in the hope that the association captive will attempt to structure a program which provides still lower premiums. A second consideration which frequently arises is the reluctance of association members to divulge information to a third party or even among themselves.* This is particularly evident when an insurance broker or agent is used to conduct a captive study, since brokers who are not included in the study may put pressure on their client members to withhold information. This situation also applies, although to a somewhat less extent, where an independent consultant is used to perform the feasibility study * * * (emphasis added).

According to information gathered by Risk Management Reports (Volume III, No. 1, January, 1976), there are now at least 30 association captives providing insurance protection to some or all of their members.

IN CONCLUSION

The product liability problem is one which stems from many complex and interrelated causes. While some problems continue in product liability insurance markets, others have been resolved and the market mechanism has been responsive as rates are becoming more closely aligned with loss exposures.

We believe the Committee should petition Congress to encourage the states to enact revisions in their respective tort laws. No action should be taken to adopt a federal insurance chartering program unless it can be convincingly demonstrated that significant numbers of group captives would be formed, that state regulatory systems in fact serve to prohibit their formation (and/or formation of similar risk pooling techniques) and that the development of such groups would provide relief for those small risks with the most difficult products loss exposures.

Since none of these conditions prevails today, the case for federal chartering lacks substance. It is both unnecessary and unwarranted. On the contrary, ample evidence does exist to demonstrate that federal chartering is not the elusive panacea which some believe will resolve the problems associated with product liability. In fact, federal chartering is in reality simply another alternative risk financing technique, yet one that undercuts the overriding and time-tested precedent of reliance on state insurance regulation.

Many alternative tools already exist to establish commercial insurance groups at the state level today. Why then should the federal government create yet another program to compete with the states and duplicate their resources?

We are convinced that in dealing with product liability problems there are no quick fixes or easy solutions.

SELECTED LISTING OF INDUSTRIAL COMMERCIAL ORGANIZATIONS THAT HAVE ESTABLISHED GROUP INSURANCE PROGRAMS

Agricultural equipment, air conditioning/refrigeration, appliance parts, apartment and office buildings, auto body, auto parts, automobile dealers, bakerys, beer and wine distributors, bicycle dealers, broadcasters, bottlers, business forms, building materials, building maintenance contractors, builders and contractors, candy, cemeteries, churches and religious institutions, civil engineers and land surveyors, colleges, schools (private, trade, other), concrete burial vault manufacturers, druggists, dry cleaners, drywall contractors, electrical appliances, electrical contractors, fabricare, farm implement dealers, fast food, financial institutions, fraternal clubs, furniture stores, fuel oil dealers, funeral directors and morticians, gas stations, glazers, graphic arts, grocers (retail), hardware dealers (wholesale and retail), hospitals, industrial equipment, industrial metalworking, industrial suppliers, jewelers and silversmiths, liquor dealers, machine tool builders, masonry contractors, mechanical contractors, medical societies, metal stampers, motel and resort owners, newspaper publishers, nursing homes and health care facilities, oil jobbers, painting and decorateing contractors, paperbox manufacturers, petroleum operators, physicians, printers, public golf courses, restaurant owners, roofers, sealant and waterproofers, school boards, soda dispensing equipment, supermarkets, tennis clubs, tile contractors, variety stores, veterinary medical associations, water conditioners, welding suppliers.

This list is far from exhaustive but includes domestic and off shore association captives, as well as organized safety groups organized to promote safety/loss prevention and generate dividends from their own good experience.

Senator PACKWOOD. Mr. Rowland?

Mr. ROWLAND. Thank you very much, Senator. My name is David Rowland. I am an independent property casualty insurance agent associated with CRB Insurance located in Racine, Wis.

Just so you are aware, Racine is situated between Milwaukee and Chicago on Lake Michigan. We do have a considerable number of manufacturing and heavy industry businesses in our community, so I don't come from the boonies talking about products liability in a vacuum.

Senator PACKWOOD. I have been in Racine.

Mr. ROWLAND. Wonderful. Come back and see us again. We would be delighted.

My name is J. David Rowland. I am an independent property/caualty insurance agent affiliated with CRB Insurance located in Racine, Wis.

I appear before you today in my capacity as chairman of the Federal Affairs Committee of the Independent Insurance Agents of America and would like to discuss with you several issues from the perspective of a true consumer oriented group.

We like to consider that we are not solely representatives of the insurance industry, but that we truly represent our clients.

Our own office represents some 20 different companies but it is our first job and our primary job to make sure that our clients who come to us for insurance are served first. We would like to make some comments about the Risk Retention Act not necessarily as spokesmen for the industry, but as spokesmen as well for our clients.

I will deviate from the printed text and ask that it be entered in the record because I know that time is of the essence.

I have heard some testimony today that would lead me to make some comments back to the folks who testified in favor of this bill and, therefore, will address my remarks as sort of a rebuttal to them.

We have five concerns that we want to express to the committee. The first concern is that the act will not and cannot itself accomplish its stated objectives. The second is that the premises of the act are anachronistic and simply do not pertain to the present insurance market. Three, that the act would needlessly duplicate and preempt the desirable and effective alternatives that currently exist under the province of State regulation. Four, the act is potentially dangerous for both the business community and the public at large because of its ineffectiveness in addressing the question of insolvency.

And I think that is a question that desperately needs to be addressed.

Finally, I would call the attention of the committee to the fundamental incompatibility of this act and the statement of public policy contained in the McCarran-Ferguson Act.

Here, again, we think that this is a dangerous inroad in the area of insurance regulation.

Going on through my remarks, I would like to point out that in our own agency, I am not aware of one commercial policy in which product liability premiums have not been reduced within the past 2 years.

This includes machine tool manufacturers, electric motor manufacturers, suppliers to the auto and aviation industry, stamping companies, forging machine shops, tool and die makers, et cetera, wholesalers and retailers.

Those who advocate enactment of this bill as a contingency for possible future repetition of the crisis of the 1970's are not only off the mark, but are basically addressing the wrong question.

The real issue, as most all agree, is in the area of tort reform. Senator Culver talked to our trade association 3 years ago and he stated that risk retention was a Band-Aid. Admittedly, almost all proponents of this act say it's Band-Aid. Well, if the wound isn't bleeding and is closed, let's not put on a Band-Aid.

Despite Commerce Department statements to the contrary, there are presently numerous viable alternatives to risk-retention groups available throughout the country. Some have been in operation for years and you have heard testimony from these other gentlemen who are more versed in this area than I am. But I do know that the States of Colorado and Tennessee have established laws permitting captives, which is a fairly new development in the insurance industry.

And these captives are created and are being used. We know of one such——

Senator **Packwood**. Let me ask you a question on that. What was the position of your State associations when those laws were being considered?

Mr. **Rowland**. Coming from Wisconsin, Senator, I can't answer that. No bill currently is before us in Wisconsin. I would suspect—personally, I would have to support it, but I certainly can't speak for my State association.

We have a pretty open law in our State that allows for many of these things. Anyway, I can address safety groups or things of that kind, if you like, later or right now, if you'd like.

But we have the availability of safety groups to insure people through the group concept in the State of Wisconsin; or at least it's being done.

I would like to point out specifically one captive that has been created. It's called WESCAP, a Colorado captive. It writes over $3 million of annual group premiums for welding supply dealers. This is an industry with serious liability exposure, as you can imagine.

WESCAP was developed by the American Insurance Marketing Corp. through its affiliated independent agents and brokers located in every State of the Union. And this is a very viable marketing scheme which is satisfying the need of that particular trade association.

Some of the Nation's largest insurance companies also have mass marketing provisions. To mention just a few examples—INA, through Marketdyne, establishes safety groups and markets particularlized policies for members of trade associations.

I would just like to point out to you how suddenly words or slogans get to be meaningful. Here's a big ad from the Insurance Co. of North America. It says, "determining risk retention levels." So immediately, risk retention has become a popular word in the industry because, I suspect, of this act. Suddenly, competitors are now jumping on what publicity this is generating.

And, really, the marketplace is able to handle effectively the kinds of problems that weren't in existence 2 and 3 years ago.

Fireman's Fund, through a slightly different system called FAMEX, provides similar services to sponsoring associations through a network of over 200 independent agents holding territorial franchises.

By the way, we understand that Fireman's Fund will be submitting a statement to you.

It should be pointed out that during the House hearings on this issue, not one small businessman stepped forward indicating any desire or intent to actually join a risk retention group. Indeed, a spokesman from the National Federation of Independent Businessmen made it clear that "a small firm would be inclined not to participate in a risk retention group if similar protection at similar cost can be obtained from conventional sources."

Small business indifference to this legislation was again displayed at the January gathering of the White House Conference on Small Business, where, after 57 State and regional meetings attended by over 20,000 individuals, and producing about 400 policy options, the concept of risk retention never surfaced. Indeed, the major problems addressed concerned Federal overregulation of small business.

We really feel that what we have is a potentially dangerous mechanism, and I would just like to point out a couple of problems that we see existing in it.

Let's suppose, for an example, that we take all of the manufacturers of sporting goods and they want to form a risk retention group. Does it mean that the fellow manufacturing golf tees is going to be lumped together with the fellow manufacturing football helmets? Are these groups going to take all comers, or are they going to pick and choose within the group those that are going to be obviously the better class of business so they can insure those at a better competitive rate level and not spread the risk throughout a given association or trade group?

I think this whole problem is rife with potential dangers that the insurance industry has addressed, albeit, sometimes not very well, but is addressing currently, today, in a competitive, open market situation.

The rates are coming down. I would suggest, gentlemen, as an alternative to passing the bill at this time, when it is really not needed—and there has been no demonstation of need with current statistics—that, again, as was suggested by a previous speaker, that information be gathered because there is a definite conflict in the testimony.

Some people are saying—some Commerce Department gentleman has said—there's an availability problem, affordability problem. And I can tell you in my situation as an advocate for the insurance consumer the salesman of the product, there isn't that kind of pressure today.

And I would respectfully recommend that this committee commission an independent study in order to reconcile some of this contradictory information that it has received.

A study might well point out the need for legislation to enable creation of risk-retention groups in another emergency situation. But it hasn't been shown by the testimony, at least as far as we are concerned, and we would like to ask that you seriously consider putting it on the back burner because of the problems that really are potentially very dangerous for the risk retention groups themselves.

Thank you very much for allowing me to testify.

Senator **STEVENSON** [presiding]. Thank you, sir.

[The statement follows:]

STATEMENT OF J. DAVID ROWLAND, ON BEHALF OF INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

My name is J. David Rowland. I am an independent property/casualty insurance agent affiliated with CRB Insurance located in Racine, Wisconsin. I appear before you today in my capacity as Chairman of the Federal Affairs Committee of the Independent Insurance Agents of America, Inc. (IIAA). Accompanying me is Lawrence R. Herman, Director of Congressional Relations of IIAA.

IIAA is a national association representing approximately 126,000 licensed independent property/casualty insurance agents and 250,000 insurance persons located in virtually every community in the United States.

Independent agents are in a unique position to address this product liability insurance issue. We are all small businessmen and write the preponderance of this line of insurance. In addition, while we all represent a number of insurance companies, our primary client is the insurance consumer—whether he be a businessman or the average man on the street—and our primary function is the placement and servicing of his insurance needs.

PRODUCT LIABILITY RISK RETENTION ACT

I must speak in opposition to S. 1789, the Product Liability Risk Retention Act. Our objections are several. (1) The Act will not and can not itself accomplish its stated objectives. (2) The premises of this Act are anachronistic and simply do not pertain to the present insurance market. (3) The Act would needlessly duplicate and pre-empt the desirable and effective alternatives that currently exist under the province of state regulation. (4) The Act is potentially dangerous for both the business community and the public at large because of its ineffectiveness in addressing the question of group insolvency. (5) Finally, I would call to the attention of this Committee the fundamental incompatibility of this Act with the statement of public policy contained in the McCarran-Ferguson Act leaving the regulation of the business of insurance to the states. I will address each of these points.

NOBLE BUT UNATTAINABLE OBJECTIVES

The four stated purposes of this Act (cited on page 2 of S. 1789) while noble aims, are simply unattainable via the provisions of this Act. I have addressed this in detail in my testimony before the House Subcommittee on Consumer Protection and Finance—on November 14, 1979—and have attached a copy of that statement for your perusal.

In summary, however, rather than lowering expenses it is just as likely that the costs of prudent capitalization and administrative expenses would be higher than current premium costs and without the protection of state guarantee funds.

Concerning claims handling, there is no reason to anticipate that a group whose primary purpose is to save money would be eager to pay out large claims without a thorough investigation.

With over 2000 competitors in the commercial marketplace of various types providing product liability coverage, the question of another vehicle for coverage is redundant.

Finally, the Act does not at all represent an alternative to off-shore captives. While this Act addresses the concern of the small business community, off-shore captives are generally attractive to large corporations seeking favorable tax treatment.

MARKET STABILIZATION

The stabilization and dramatic evolution of a sophisticated product liability insurance marketplace over the past few years negates the necessity of this legislation. Not only is the "crisis" and "panic pricing," of the 1976/1977 period past history, it represents a combination of events that would be extraordinarily difficult to repeat.

An insurer group could probably address this issue far better than I, but essentially the "crisis" was not merely a result of a downturn in the underwriting cycle, but that combined with inflationary pressure, investment difficulties and some fundamental and unpredictable reinterpretations of product liability legal theory. This produced not just "uncertainty" but created an environment in which potential liability was simply unknowable. The recent California Supreme Court ruling concerning DES dramatically illustrates this point.

I might point out that in my own agency, I am not aware of one commercial policy in which product liability premiums have not been reduced. This naturally includes machine tool manufacturers and others dealing with potentially hazardous products.

Those who advocate enactment of this bill as a contingency for a possible future repetition of the "crisis" of the 70's are not only off the mark, but are basically addressing the wrong question. The real issue, as most all agree, is in the area of tort reform.

NUMEROUS ALTERNATIVES TO RISK RETENTION GROUPS

Despite Commerce Department statements to the contrary there are presently numerous viable alternatives to risk retention groups available throughout the country. Some have been in operation for years, but grew in popularity following the capacity crunch of the mid 70's.

The States of Colorado and Tennessee allow for the establishment of captive insurance companies to be domiciled within their boundaries. Colorado has been most prolific in this area, currently posting about 30 such domestic captives, at least 8 of which are association captives. These captives are interstate in nature. Based upon this experience Colorado Commissioner of Insurance, J. Richard Barnes has testified that "there are adequate vehicles available to take care of the problem already and there is no need for the federal government to become involved."

I might note that the state of Virginia has just enacted a captive law and that the New York legislature is working on such an arrangement.

One such Colorado captive called WESCAP, currently writes over $3,000,000 in annual premiums for welding supply dealers—an industry with serious liability exposure throughout the country. WESCAP was developed by the American Insurance Marketing Corporation (AIM), through its affiliate independent agents and brokers located in every state of the Union.

AIM is by no means the only organization providing mass marketing services to groups and associations. Another called MMI or Marketing Management, Inc., located outside of Birmingham, Alabama, markets insurance to numbers of sponsoring associations through a network of about 300 independent agents in all states.

Some of the nation's largest insurance companies also have mass marketing divisions. To mention just a few examples; INA, through Marketdyne, establishes safety groups and markets particularized policies for members of trade associations. As these current advertisements indicate, INA has been vigorously marketing these services.

Fireman's Fund, through a slightly different system, which they call FAMEX, provides similar services to sponsoring associations through their network of over 200 independent agents holding territorial franchises. By the way, we understand that the Fireman's Fund will be providing this Committee a written statement detailing this operation.

These represent only the tip of the iceberg. Royal Insurance has Royal Guard and RISC, AIG has MARKETPAC, etc., etc. Other vehicles such as reciprocals and mutual groups, excess and surplus lines coverage and insurance exchanges, etc. are also currently available and being effectively used.

Again despite Commerce Department claims to the contrary there are obviously no barriers preventing such arrangements from being established. AIM has indicated, for example, that it took several weeks to put together WESCAP. The evidence clearly indicates that any association seriously interested in having such a program developed can avail itself of any number of willing providers.

It should be pointed out that during the House hearings on this issue not one small businessman stepped forward indicating any desire or intent to actually join a risk retention group. Indeed a spokesman from the National Federation of Independent Business made clear that "a small firm would be inclinde not to participate in a risk retention group if similar protection at similar costs can be obtained from conventional sources."

Small Business indifference to this legislation was again displayed at the January gathering of the White House Conference on Small Business where, after 57 state and regional meetings attended by over 20,000 individuals produced about 400 policy options; the concept of risk retention never surfaced. Indeed, the major problems addressed concerned federal over-regulation of small business.

SERIOUS PROBLEMS WITH THE LEGISLATION

In their zeal to overcome these so-called state barriers, the drafters of this legislation have created some serious problems. While there is an alarming degree of regulatory discretion provided to the Secretary of Commerce, unfortunately nothing in the bill vigorously addresses the area of insolvency or consumer protection. In fact, the bill suggests that those provisions of state law designed specifically to protect businesses and consumers from the dangers of insolvency and fraud are deemed to be "inappropriate and costly" for risk retention groups. I can not imagine that it is the intent of this Congress to expose the public to these dangers, yet that would be the result, unless of course the coffers of the U.S. Treasury are opened as a source for a Federal guarantee fund. Again, I question whether that is the intent of Congress.

Other technical and regulatory weaknesses emerge from the bill, but most of these points are already included in the record. I must, however, point to the enormous potential for fraud and abuse inherent in Title II of this Act. It could easily encourage groups to seek out risk retention group status solely for the purposes of circumventing the protective clauses of state regulatory requirements. Indeed, in his remarks concerning the dangers of the Risk Retention Act, Congressman James Collins suggested that many would seek out this vehicle to get a "free ride with lower rates."

DIRECT AFFRONT TO M'CARRAN-FERGUSON ACT

Leaving aside the details for a moment, what I regard as one of the more chilling presumptions of S. 1789 is its intent to defy established public policy and reverse the McCarran-Ferguson Act's prescription that it in the public interest for the states to regulate the business of insurance. This legislation would set a major precedent.

Is it the intent of this Congress that this official public policy be reversed? Does the Congress seriously question the propriety or the capacity of the individual states to continue to regulate the business of insurance in general or product liability insurance in particular? That would be the effect of enactment of this misdirected legislation. I can not see that the facts warrant this disruptive and radical action; and I urge you to defeat this legislation.

INDEPENDENT STUDY RECOMMENDED

As I suggested earlier, the information that served as the basis for the House of Representatives vote to pass this bill is incomplete, outdated and in some instances unfounded. If, however, this Committee has any substantial doubts as to the accuracy of this statement, I would respectfully recommend that this Committee commission an independent study in order to reconcile some of the contradictory information that it has received.

Specifically, proponents of S. 1789 contend that this product liability insurance question must be addressed thorugh federal legislation. Our evidence draws a contrary conclusion; that numerous mechanisms have been devised to address this matter within the scope of state regulation. The Department of Commerce maintains that significant "barriers" prevent viable alternatives to risk retention groups from emerging. Again, we submit that there are dozens of competitive vehicles currently being utilized by hundreds of groups. Some argue that the commercial marketplace can not respond adequately to cyclical fluctuations in the availability of insurance. Others assert that a singularly unique set of conditions exacerbated this in the mid seventies and that despite this the marketplace has effectively responded and has stabilized. This list can go on and on.

Naturally, all are entitled to their own opinions, but not to their own facts. What is in contention here is not a mere differing of opinion, but rather the apparent existence of several distinct sets of facts. The politically charged atmosphere of a hearing room may not be the most suitable forum in which to disentangle such conflicting data. We believe that an objective examination of the prevailing situation may be in order.

Passage of this legislation could have tremendous implications for the future regulation of the business of insurance. I trust that Congress would not commit itself to such a precipitous decision without a complete and balanced picture of how the product liability marketplace has actually responded to a long faded crisis.

I thank you on behalf of IIAA for providing me with an opportunity to address this complex but important aspect of the commercial life of our country.

Senator STEVENSON. Senator Packwood, any questions?

Senator PACKWOOD. I have just a couple of questions.

Mr. Rowland, by and large, I like independent insurance agents, and I frequent their insurance because I always feel they are on my side rather than the company side. That may be an illusion, but at least I have a sense of a friend on my side.

I preface my question with that. Then let me ask you, has there been any general philosophical change in the position of independent insurance agents nationwide or in your State generally, or in opposition to either group or self-insurance?

Mr. ROWLAND. Generally, I think there has been a move away from that opposition.

Senator PACKWOOD. The reason I ask, it is perfectly understandable there is nothing wrong with representing your people. They sell individual policies. If there are group policies, there are fewer to be sold.

The reason I was intrigued, about 6 or 7 years ago, the medical association was up in arms about medical malpractice, and they wanted a Federal medical malpractice insurance act, which was opposed by your group, opposed by most of the insurance companies, independent insurance agents, probably most of the witnesses that are here, or their predecessors.

Then, when the physicians went to the Maryland Legislature to get self-insurance, it is my understanding the Maryland Association of Independent Insurance Agents opposed in the Maryland Legislature the right to self-insurance.

It seems to me you can't always have it both ways. You can't come here and say, leave it to the States and then go to the States and say, don't do anything, if, indeed, the group that is being insured doesn't think it is getting adequate service.

And I think this is a position that is made if we are going to get into a debate on this on the floor—it is going to make your position somewhat vulnerable.

I would like to know whether your State insurance association opposed the Tennessee and Colorado laws when they were passed. It seems to me they would.

Mr. Rowland. Are you saying those associations in those States?

Senator Packwood. State associations. Just my hunch.

Mr. Rowland. I wish I could stand up and say I could refute, but I cannot.

Senator Packwood. I may be wrong. I have just got a hunch that maybe the situation—however, if they worked out and discovered the people, then come and say that they work fine and leave them alone to do it in the States.

Next I want to address myself to both the American Insurance Association and the Alliance of American Insurers.

Again, I go back to my State legislative days. We used to have a monopoly system on workers compensation. Only the State could provide it.

During the midsixties, that was changed to a three-way system of the State writing self-insurance or purchasing it from insurance companies.

By and large, the major insurance companies supported the expansion but opposed self-insurance, not wanting the companies to insure themselves.

Would that still be a general philosphical position of your associations?

Mr. Jordan. I don't know the specific example with regard to workman's comp. I could say more generally, I think that there has been some reticence in regard to supporting self-insurance initiatives in the past, I think it's only fair to say.

But I do sense that is definitely easing today. Our position on captives today is we are neutral. We are neutral in the sense that we are not going to go off and try to beat the bushes down to see more captives formed. At the same time, we have total empathy with the objectives of the people who are going to go out and form them.

I hope that's been responsive.

Mr. Connolly. Well, I'll parallel with that to the extent what we tended to look at in medical malpractice self-insurance mechanisms at the State level was the degree of regulation to insure that the regulations were, A, sound and B, competitive, so that there would be a possibility for the commercial insurance market if it was not servicing that market, to reenter.

We don't necessarily favor self-insurance because we think we can do it better. But in terms of the statutory regulations concerning that area, generally our concern is that they ought not to obtain a competitive advantage. They ought to be regulated in a sound manner, and that is a position.

Senator Packwood. Last question of Mr. Rowland. Mr. Rowland, you'd like an independent study before we act?

Mr. Rowland. Yes, sir.

Senator Packwood. Any objections to the Federal Trade Commission doing it?

You don't have to answer that one. I have no further questions, Mr. Chairman.

Senator Stevenson. Thank you very much, gentlemen.

Our next panel consists of Barbara Pequet, legislative director, National Consumers League; Thomas Bendorf, Association of Trial Lawyers of America; and Curtis Urbanski, American Insurance Marketing Corp.

STATEMENTS OF BARBARA K. PEQUET, LEGISLATIVE DIRECTOR, NATIONAL CONSUMERS LEAGUE, WASHINGTON, D.C.; C. THOMAS BENDORF, DIRECTOR, NATIONAL AFFAIRS DEPARTMENT, ASSOCIATION OF TRIAL LAWYERS OF AMERICA; AND CURITS G. URBANSKI, PRESIDENT, AMERICAN INSURANCE MARKETING CORP.

Mrs. Pequet. Mr. Chairman, I am Barb Pequet, legislative director for the National Consumers League. We appreciate the opportunity to appear before you today to present our comments on S. 1789, the Product Liability Risk Retention Act of 1980.

Fairness and economic equity in the marketplace have been important goals of the National Consumers League for eight decades. NCL has worked to improve competition, to enhance the delivery of quality goods and services, and to promote consumer involvement in marketplace decisions through self-help, consumer based, participatory measures—some of the very purposes of the bill before us.

The National Consumers League has endorsed and testified in support of the companion bill, which recently passed the House of Representatives, for the same reasons I will outline today.

Three years ago, the National Consumers League testified before this committee to recommend a reasoned approach in analyzing the current product liability crisis. Although NCL does not believe we have been in a crisis situation, as some have suggested, we have been concerned about the severe economic problem some product sellers and small businesses were experiencing in certain industries. As a result of enormous increases in product liability insurance premiums, in some cases as great as 1,000 percent in 1 year, and of increases in deductibles, coverage has diminished.

The affordability problem caused many product sellers and small businesses to "go bare" and thereby risk not only bankruptcy for themselves, but gross injustice where innocently injured consumers are physically harmed by a defective product but receive little or no recompense or compensation for their losses.

In November, 1977, the interagency task force on product liability published its analysis of the causes of the product liability problem in the final report. It concluded that such uncertainties as data reporting and other insurance industry ratemaking procedures were significant causes of the problem.

The additional causes, unsafe manufacturing and unpredictability in the tort-litigation system, were also cited. They seemed secondary to the NCL.

The National Consumers League considered the most significant solution of the liability problem the improvement of product safety.

It should be noticed before we consider solutions that in product liability cases a threshold injury must occur. The injured consumer then proves that the unreasonably unsafe product was faulty in design, or warning, or manufacturing. Thus, making products more safe would reduce product liability losses in the long run and should be our highest priority solution.

The second most reasonable solution is to reduce the subjective ratemaking procedures currently allowed for underwriters. Because product liability ratemaking procedures are complex, are determined on a national basis, and are not available under monoline coverage, close scrutiny is difficult.

Although insurance companies must file an annual statement in each State with precise data on most types of insurance coverage, product liability data is not required.

Further, in the financial reporting of losses, the insurance industry may presently employ sheer speculation. As was mentioned, of up to 80 percent when accounting for its reserve practices. Losses include the actual amount paid out on claims. Losses also include money put in reserves to cover unpaid losses on claims reported but not paid, and on claims thought to have been incurred but which have not been reported.

These speculative, overreserved losses are used in figuring the profitability of insurers.

Where rates are determined by subjective judgment, about 80 or 90 percent of all product liability premiums, the profitability of a company, drastically lowered by overreserved losses, weighs heavily in the rate determination.

In the end, insurance companies may increase investment income while claiming a need for drastic increases in premiums. The result—some businesses have to make serious sacrifices to retain coverage, others are forced to go without and risk liquidation if sued.

Senator **Packwood**. Can I stop you for just a second? Mr. Chairman, I have to leave and I want one clarification for the record.

I made the statement that the Maryland Association of Independent Insurance Agents opposed the passage of the Maryland malpractice health insurance law.

That was based on a phone call that Larry Herman made to the Baltimore office of the headquarters of the Maryland Association of Independent Insurance Agents. They told him, yes, we opposed the law.

However, Dr. Manning Alder, who is the executive director of the Maryland Malpractice Mutual, says the insurance agents supported the law.

I just want the record to indicate that the insurance agents said they opposed it and the doctor that runs it says they supported it. I have to go.

Senator **Stevenson**. Please proceed.

Mrs. **Pequet**. Sure. I have just a few more points.

The third solution being offered at the State and national level is the curtailing of consumers' rights by tort reform. The National Consumers League remains adamantly opposed to solving the problem by denying injured consumers their legal rights.

State bills which arbitrarily cut off the consumer's right to sue and which give manufacturers and businesses defenses that deny consumers justice are no solutions to this problem.

Similarly, the model uniform statute which codifies several of these consumer rights curtailments is neither a solution to the product liability problems nor a measure the National Consumers League can support.

One solution in the interagency task force's option paper which does address consumers' needs is the principle of self-insurance or risk retention. By allowing product sellers to form their own insurance cooperatives or risk retention groups several consumer needs will be met.

There are three—affordable coverage, competition, and safe products.

Affordable coverage. It is in the consumer's interest for manufacturers to have reasonably priced insurance coverage available to them. Consumers stand to be hurt when there is not coverage available and when they cannot have their claims met. Similarly, costs that accrue to premium prices in insurance coverage that are added onto products certainly are passed on to the ultimate consumer.

Consumers need competition in the insurance industry. It is apparently not very competitive. As a result of the formation of self-insurance groups, rates will reflect more accurately what the market will bear. The use of highly subjective, speculatively figured rates will diminish. As more risk retention groups are formed, the strong competitive demand will be on insurance companies who currently provide coverage only at inflated rates.

Consumers, the marketplace, and the economy will benefit from this competition.

A third need is safe products. Product safety can be enhanced by increasing loss prevention services and techniques. Small, self-insured groups will have firsthand product data to be applied to reducing the risk of injury and death.

In addition, loss prevention techniques can be finally and specifically turned to accommodate small business' special needs—a quality of loss prevention advice not frequently available.

In sum, the Risk Retention Act is something the National Consumer's League would like to see passed. If we look at the history of medical malpractice insurance, although quite different from product liability problem, we find today physician-run companies charge significantly lower rates than commercial carriers.

Even without the low overhead, good screening processes, and the nonprofit purposes, product liability groups are also certain to operate successfully at lower rates than commercial companies.

This Federal bill does not challenge the States' ability to regulate insurance. It does not preempt State laws except where State laws prohibiting the forming, functioning, or group purchase of insurance through approved product-liability risk retention groups.

Further, States acting alone cannot advance the formation of risk-retention groups since individual State's legislation would vary widely. A Federal bill which allows product sellers from any State to form or join these self-insurance groups is what is needed.

Finally, the Risk Retention Act of 1980 does not create a new Federal bureaucracy. It does not even substitute one batch of regulations for a different one. Instead, the act organizes an adaptable system which will operate to reduce the cumulative amount of regulation. In short, State regulation aimed at guaranteeing the solvency of commercial insurers will be more finely honed so as to not prohibit this needed solution.

The National Consumers League on behalf of its affiliates and members thanks you for your attention. We will be glad to answer additional questions.

Senator STEVENSON. Thank you.

Mr. BENDORF. Mr. Chairman, I commend you on your durability. I will make my testimony as brief as my statement is long. I will try to be as gentle as my statement is acerbic.

We have supported and continue to support the Risk Retention Act as a safety valve mechanism. We have heard a lot today about how it is unneeded and potentially uncompetitive.

The bill provides a sunset provision which will obviously allow it to die; A, if it is unneeded, B, if it cannot compete with commercial insurance, and C, if in fact those companies who have expressed themselves so loud and so well to the Congress of the United States do not finally satisfy the requirements of the act.

We recommend as well the provisions of tax equity which would allow self insurance program equity in tax treatment. And with these two provisions, we believe that a dual safety valve will have been created which will allow consumers of insurance some freedom in determination of whether they go commercial or whether they self insure; whether they create mutuals, reciprocals or captives.

We have a difficulty understanding why an enlightened insurance industry doesn't recognize further that the very limited aspect of this bill would tend to relieve pressure that is building for the repeal of the McCarran-Ferguson Act. I am sure that the industry cites this bill as a camel's nose under the tent.

I would recommend it to them as a safety valve which may serve to reduce substantially the pressure for Federal regulation of the insurance industry. I don't think we need that battle. I would prefer that that battle doesn't come, and I recommend strongly that this act be passed to allow some experimentation short of drastic annihilation of the principle of State regulation.

I would be happy to answer any questions. I would be most happy to work with the staff any way the staff would wish in providing research and materials. And we, the Association of Trial Lawyers of America appreciate the opportunity to testify.

Senator STEVENSON. Thank you, sir. Your statement will be enclosed.

[The statement follows:]

STATEMENT OF THE ASSOCIATION OF TRIAL LAWYERS OF AMERICA

INTRODUCTION

Mr. Chairman and members of the Senate Committee on Commerce, Science, and Transportation. I am pleased to be here today to testify on behalf of the Association of Trial Lawyers of America. My name is C. Thomas Bendorf and I am the Director of the National Affairs Department of ATLA. ATLA is a national law association representing over 40,000 members of the trial bar in 50 states. For the most part, our members represent the interests of injured consumers and users of products, rather than the defense of the manufacturer and seller of those products. I appreciate this opportunity to present the views of ATLA to this Committee on the subject of product liability insurance in general and the Risk Retention Act in particular.

Product liability insurance is a difficult subject, one for which answers are not readily apparent. We applaud the willingness of this Committee to again undertake to study and understand it, and we hope that in some small way ATLA is able to help you solve the problem raised by the lack of true knowledge available.

Since it has been almost three years since this Committee has developed a formal hearing record on product liability insurance, I would like first to address myself briefly to what has and has not transpired during that period, and then to invite your attention to some interesting data we have uncovered in our pursuit of answers. With that as background, I will then move on to why ATLA supports the Risk Retention Act and other "safety valve" mechanisms.

PRODUCT LIABILITY INSURANCE DATA

It was over three years ago, on September 6, 1976, that we first testified on the subject of product liability. Robert G. Begam, then President of ATLA, testifying before the Senate Small Business Committee, of the United States Congress, referred to the "Let's you and him fight" attitude of the casualty insurance industry. He added:

"[A]s long as the threat of excessive claims can be imagined, the insurance industry will be shrieking for relief but, like an Edgar Bergen, through the lips of whatever captive is currently subject to their unusual and unconscionable pressures. It may be that there is something wrong with the insurance industry, and if there is, Congress has the ability to find that out. It may be that there is something wrong with our courts and our techniques for administering justice, and if there is, Congress has the ability to find that out. I cannot believe, however, Mr. Chairman, that there is anything wrong with protecting innocent victims from the wrongdoing of others or compensating them fully when a wrongdoer has deprived them of life, health, ability, or the enjoyment of life. The insurance commissioners of the various states have been unable to get information they wish from the insurance companies on their experience in the products liability field. Congress was unable to get from the insurance companies precise figures on their (immunization) drug experience, but when examined by Congress, the insurance industry could remember only a handful of claims in the last five or six years. Surely, in this computer age, they have adequate information on which to base any conclusion they might wish to reach. This information should be presented to you in precise terms. It should describe to the dollar the premiums collected; it should describe to the dollar investment income on any reserves; it should describe to the dollar the amount of claims settled; the amount of claims filed; in short, their entire experience, not in percentages, but in dollars * * *."

"We have been disputing auto reparations for some eight years. We still lack figures that justify their generalities. Only the industry has the information. The price of admission to the arenas of controversy should be, at the very minimum, truth and candor. We are calling upon Congress for a comprehensive and total investigation of the insurance industry. We will repeat this call at every opportunity in the Nation's Capital, and at every opportunity in every State capital. The American public long enough been inundated with slogans and catch phrases. If the new motto is to be 'We can no longer afford the protection of human rights,' then at least let the burden be on those who would deny the rights.

"They and they alone have the information. You and you alone can force it from them."

In our appearance before the House Subcommittee on Capital, Investments, and Business Opportunities, of the Committee on Small Business, chaired by Congressman John J. LaFalce (D-NY), on November 28, 1977, we said,

"This constitutes our sixth appearance before Congress on the subject of Product Liability Insurance. In our first testimony in September 1976, we said that surely, in this computer age, the insurance industry must have adequate information, and that that information should be presented to you in precise terms. We suggested that the information should describe, to the dollar, the premiums collected; it should describe, to the dollar, investment income on any reserves; it should describe the number of claims made, the number settled, and, to the dollar, the amount of claims settled.

"Over a year later, Mr. Chairman, and to a great extent through your efforts, some specific information is being made public.

"Much of this mass of material cannot be classified as hard data. Much of it that can be is conflicting, and must be compared to earlier statements out of the same mouths before valid conclusions can be drawn. Much information is still to be made public. In January of this year, Acting Federal Insurance Administrator J. Robert Hunter was quoted as saying that 'meaningful insurance data is the closet thing to a perfect vacuum that man has ever created.' That may or may not be true eleven months later but it is clear that many questions propounded by you, Mr. Chairman, and by others, have yet to be answered in satisfactory fashion."

We pointed out at that time that our concern and frustrations were echoed in the Final Report of the Federal Interagency Task Force on Product Liability (IATF-PL), which was replete with admission, disclaimers, and warnings based on the inadequacy of the available information.

Later that year, in our Comments on the Final Report of the IATF-PL, delivered to the LaFalce Subcommittee on December 29, 1977, we said in part:

We have consistently suggested that there was only a crisis created by the casualty insurance industry, created out of whole cloth, a crisis of no real cause, serving only the insurance industry's political goals and maneuver that made unwitting pawns and victims of manufacturers, sellers, and consumers.

"Not a shred of evidence refutes our contention. Not a word of evidence demonstrates that the 'uncertainties of the tort-litigation system' contribute to the unaffordability or unavailability of product liability insurance. The industry has not yet revealed the premium income for product liability insurance, the total number of claims paid, the cost of those claims, the reserves generated by this line, the reserve investment income realized from this line, or any other information which will support the contention that 'uncertainties' contribute to anything other than the insurance industry's extrasensory rate hikes."

Since that time, we have continued to apply ourselves to our own study of insurance. We have taken great pains, and undergone quite a little expenses, to discover what insurance documents among the myriad of filings, compilations, and propaganda are useful. We have subscribed to almost every property/casualty item produced by the A. M. Best Company and have gone over each of them with diligence and care. When puzzled by inconsistencies and unverifiable statements, we have asked for clarification, but have seldom received it. We have consulted and briefed, at every opportunity, all over the country.

What have we learned in these three years? Very little. What we have learned, we have not learned from the insurance industry.

We have learned that the million claims a year are more like 70,000. We have learned that no one can find the fabled lawnmower case.

We know that some limited studies show a reduction in claims in some states.

What we have not learned is the following:

1. What are the premiums paid by the industry for product liability insurance.
2. How many claims were filed.
3. How many claims were closed.
4. How much was paid out for claims closed.
5. How much is reserved and in what types of reserves.
6. How much was earned by investing those reserves.

This is the information that is required, absolutely required, before reasonable conclusions about the "problem" can be suggested. We know the rates have risen drastically, dramatically, and damnably, but we have every reason to believe they have not risen justifiably.

In "Insurance Facts 1976" the Insurance Information Institute said,

"Products Liability: The annual number of products liability cases was estimated at 50,000 in the 1960's, had multiplied to 500,000 by the 1970's, and is now believed to be approaching one million. Judgments running into millions of dollars, unknown a few years ago, now are frequent. Here, too, premiums are being forced up rapidly and in some cases coverage is becoming hard to get. The resulting problem is one which could affect the price or availability of nearly every product on the market and could seriously impair the ability of many businesses or industries to function."

In "Insurance Facts 1978" the Insurance Institute said,

"In the specific area of product liability, a federal Interagency Task Force estimated that 60,000 to 70,000 claims were filed in 1976. The Task Force said that while the situation is not a crisis, it does 'present a potential disruptive effect on the economy.' The number of product liability lawsuits in U.S. District Courts rose 10.3 percent in fiscal 1977 (ended June 30) as compared with fiscal 1976.

"Meanwhile, the findings of a survey by Insurance Services Office showed that 87 percent of bodily injury payments and 89 percent of property damage payments in product liability cases are covered by insurance. The survey also showed the high cost of defending claims to be a significant contributor to the product liability problem. ISO said that for every dollar paid for claims, insurers pay an average of 35 cents more for defense costs in bodily injury cases; 48 cents in property damage cases, no matter who wins the cases."

In "Insurance Facts 1977" the Insurance Information Institute said,

"Estimates for 1976 indicate a $2.2 billion underwriting deficit, representing a statutory underwriting loss of $1.58 billion plus payments of $640 million in dividends to policyholders. The 1976 underwriting losses, following losses aproximating $4.25 billon in 1975 and $2.6 billion in 1974, brought the total loss on underwriting operations for the nation's property and liability insurers to more than $9 billion in the three-year period 1974–76."

In "Insurance Facts 1979" the Insurance Information Institute said,

OPERATING RESULTS, PROPERTY/CASUALTY INSURERS

"Profits and losses of property and casualty insurance companies, particularly in recent years, have been subject to greater fluctuations than those of such other industries as banks, utilities and industrial companies. Separate analyses show that: Although the property/casualty business registered underwriting profits, after payments to policy-holders, in 1977 and again in 1978, the industry during last quarter-century has recorded a net underwriting loss, after policyholders' dividends, of more than $8.3 billion. The industry has shown profits on underwriting operations in only 11 of the last 25 years and in only five of the last 15 years (table I). Investments of capital and surplus accounts, together with money set aside as loss reserves and unearned premium reserves, have generated income in those 25 years (table II), thus permitting companies to continue their insurance operations despite the frequent underwriting deficits.

"Data provided by the National Association of Insurance Commissioners covering an eight-year period show that the industry's annual income on sales ranged from a 1.8 per cent loss in 1975 to a 5.9 per cent gain in 1978. The NAIC found that profits considered as a return on net worth, which were 15.4 per cent in 1971, tumbled to a low of 1.8 per cent in 1975 before recovering and reaching levels of 19.6 per cent in 1977 and 19.8 per cent in 1978."

I.—UNDERWRITING GAINS/LOSSES AFTER POLICYHOLDERS' DIVIDENDS

PROPERTY/CASUALTY INSURANCE BUSINESS—1954–78

Year	Amount	Year	Amount
1954	$506,561,238	1967	−$254,958,281
1955	311,618,658	1968	−568,749,057
1956	−189,962,159	1969	−1,047,954,242
1957	−409,063,643	1970	−425,781,395
1958	−75,360,296	1971	826,171,778
1959	127,487,415	1972	1,061,651,090
1960	149,827,774	1973	6,063,446
1961	164,821,263	1974	−2,644,898,126
1962	46,514,135	1975	−4,226,797,675
1963	−508,431,662	1976	−2,188,651,570
1964	−672,106,297	1977	1,111,802,569
1965	−709,529,514	1978	1,296,331,[illegible]
1966	−19,874,782		

Source: Best's Aggregates & Averages.

In "Insurance Facts 1979" the Insurance Information Institute said:

ASSETS AND POLICYHOLDERS' SURPLUS—1954–78

Year	Assets [1]	Policyholders' surplus
1954	$20,416,474,686	$8,391,745,213
1955	22,304,574,053	9,461,461,208
1956	23,105,999,312	9,606,823,494
1957	23,448,699,858	8,859,054,957
1958	26,308,586,493	10,678,793,572
1959	28,601,876,057	11,632,988,742
1960	30,132,406,146	11,929,916,532
1961	33,690,107,050	14,594,277,025
1962	34,216,778,301	14,143,661,471
1963	37,076,168,470	15,747,425,458
1964	39,864,789,714	16,990,160,965
1965	41,842,855,546	17,111,905,675
1966	42,288,391,548	15,556,228,227

ASSETS AND POLICYHOLDERS' SURPLUS—1954–78—Continued

Year	Assets [1]	Policyholders' surplus
1967	46,561,650,223	17,500,514,573
1968	51,225,612,595	19,106,998,848
1969	52,368,770,719	16,719,316,875
1970	58,593,659,921	18,520,912,881
1971	67,284,413,414	22,749,478,855
1972	78,885,040,254	28,211,379,307
1973	83,862,353,131	27,091,141,493
1974	82,115,346,219	20,898,084,479
1975	94,118,024,372	25,302,572,639
1976	112,974,633,256	31,394,299,646
1977	135,513,191,258	37,371,668,356
1978	160,059,668,932	45,003,817,092

[1] All figures are industry aggregates. Consolidated totals for the three most recent years (computed by eliminating interownerships within company groups) are estimated at: assets, 1976, $105.6 billion; 1977, $126.6 billion; 1978, $149.1 billion; policyholders' surplus, 1976, $24.6 billion; 1977, $29.3 billion; 1978, $35.4 billion.

Source: Best's Aggregate & Averages.

Anyone whose assets can increase from $20 billion to $160 billion and whose net worth increases from $8.4 billion to $45 billion while losing $8.3 billion should need little else from life but continuing losses.

Again, in 174, 1975 and 1976, they lost $9 billion. During this period, their assets increased $30 billion and their net worth increased from $21 billion in 1974 to $31 billion in 1976.

The public has been told by a number of insurance spokesmen that Product Liability insurance is most like Medical Malpractice insurance because of its "long tail", high awards, etc. We do know a little something about Medical Malpractice because the industry began reporting it as a separate line in 1975.

St. Paul Fire and Marine Insurance Company is the largest single underwriter of Medical Malpractice insurance in the United States. In 1978 it accounted for about 10 percent of all such premiums written.

Let's look at their crisis.[1] In 1977, they received $128 million in premiums and paid out for occurences in 1977, the year the premiums represent, $1.4 million in claims. For claims for all prior years plus 1977, they paid out $5.1 million, just under 4 cents on the dollar.

In 1978, they took in $131 million in premiums for 1978 occurences and paid out $10.3 million for all claims, just under 8 cents on the dollar.

All this information is contained in their Convention Statements[2] on file with each State insurance commissioner. The reserves for losses and loss adjustment expenses were over $138 million in 1977 and $201 million in 1978. The investment income for these years on their loss reserves is better than twice the claims paid.

Does St. Paul differ from the industry as a whole?

"One Hundred and Fifty Selected Companies"[3] showed premium income of $1.164 billion for 1978 occurences and $7 million for claims paid or 6 mills on the dollar. For four years these companies had premium income of $3.949 billion while paying $190 million in claims, or less than a nickel on the dollar. Their reserves at the end of these four years totaled $2.958 billion.

Again, we mention Medical Malpractice because some spokesmen say it's most like product liability.

Let's turn our attention to General Liability, the line of insurance which includes most product liability coverage.

Just for comparison purposes, let's look again at St. Paul.[4] These figures are the combined figures for 1973 through 1978. These years obviously cover the disastrous years of 1974, 1975, and 1976. Let's see how St. Paul has done on General Liability.

Premium income, $840 million. Incurred losses, $725 million. Paid out for those six years' occurences, $204 million, less than one quarter of the six year premiums. What have they in reserves for General Liability? $520 million. Their investment income, estimated at a very conservative 5% ROI, equals $81 million.

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[1] Appendix pages B-18 through B-21; Chart C-1.

[2] Excerpts from St. Paul Fire and Marine Insurance Company's 1978 Convention Statement appear on pages A-1 through A-19.

[3] Appendix pages B-14 through B-17; Chart C-2.

[4] Appendix pages B-26 through B-29; Chart C-3

If there is much Product Liability in their General Liability, and St. Paul says that there is an insignificant amount, it would appear that success in the other parts of General Liability have cushioned the impact that the product liability crisis might have had.

However, to be more accurate with a larger sample, let us examine 200 selected companies in the same categories of General Liability.[5]

First, the disastrous years, 1974, 1975 and 1976. Premiums, $8.592 billion. Losses incurred, $7.216 billion. Claims paid against those premiums, $2.625 billion. Reserves for those three years, $3.577 billion and an investment income estimated at $900 million.

For the last six years, 1973 through 1978, how did these 200 companies do?

Income two-and-a-half times greater, $21.158 billion. Incurred losses over two times greater, $15.657 billion. Claims paid less than two times greater, a mere $4.479 billion. Total reserves almost three times greater, $10.442 billion. Investment income a paltry $1.550 billion.

If Product Liability is as unhealthy for underwriters as Medical Malpractice is they should muddle through somehow. If Product Liability is *in fact* a loser then it seems to be quite well cushioned in the experience demonstrated over the last six years for the 200 companies reported.

And, finally, if this disaster is so great as to lead to crisis proportions, the Casualty Insurance industry should be delighted to rid themselves of these loss leaders and join us in our support of the Risk Rentention Act which has been reported by the U.S. House Committee on Interstate and Foreign Commerce and in the "tax equity" proposals regarding self-insurance which are pending in both chambers of the United States Congress.

We presume that accurate and complete disclosure of Product Liability experience simply does not enjoy a high priority with the industry, but it should enjoy a very high priority with the state legislatures and with the U.S. Congress.

Insurance data should not be mysterious. If one wishes to raise the price of an expensive and necessary product, the seller should be able to demonstrate a factual basis for such a raise. This seems inordinately true when the raises are in four figures ahead of the decimal point, and the seller is an allegedly regulated industry.

Congress asked for this information in 1976, and again in 1977. Chairman John LaFalce was granted some responses, but none that demonstrated the basis of the premium increases.

It is eminently clear that the injured victim should not be asked to subsidize lower insurance rates by giving up his right to reparation. He, the consumer of the defective product, has little enough going for him now. However, the other consumer, the purchaser of the insurance policy needs a better break also. He stands to benefit heavily through various risk retention proposals without the necessity of eliminating any rights.

But every consumer, product purchaser, insurance purchase or innocent bystander can reap great benefit through effective "Truth in Insurance" proposals. How can anyone in the nation be harmed by the introduction of truth?

We suffered the indignity of ignorance when the industry was content with some losses coupled with enormous growth. They tended to mind their own business, the business of spreading risk, and to a great extent they left the business of nurturing, husbanding, and enhancing human rights to the courts, juries, legislatures and to Congress.

However, if the goal is now the "reforming" of these hard won rights that every citizen enjoys, reforming out of existence these right, then it is not inappropriate for these citizens to ask for facts.

All who have studied the crisis or the problem or the inconvenience or whatever it is that the industry suffers have indicated that the rate increases bear no causal relationship to claims and awards.

We simply do not think it is too early to expect that relationship to be established. The facts should certainly precede any "tort reform" action.

THE RISK RETENTION ACT AND OTHER MECHANISMS

While we continue to pray for and await disclosure of the information essential to intelligent decision-making in the product liability insurance area, there are some "safety valve" mechanisms which can be enacted, and should be enacted, without further delay. One is the Product Liability Risk Retention Act which is before you today in two versions, S.1789 and H.R. 6152, the latter as passed by the House. Other proposals, commonly known as "Tax Equity" bills, are pending before the

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[5] Appendix pages B-22 through B-25; Charts C-4 and C-5.

Senate Finance Committee, and would benefit not only product manufacturers and sellers but doctors, lawyers, design professionals, and other as well.

An insurance company in its insurance business, collects from those whose risks it underwrites enough money to pay its expenses, it profits, and sufficient money to settle any claims that should arise. It studies how often it expects an occurrence, and the probable severity of the occurrence, and whatever inflationary factors may be expected to impact in the ensuring period.

It then describes as incurred losses and expenses the claims it has paid for occurrences of the current year and all prior years, all lost adjustment expenses, changes in reserves for known claims, changes in reserves for claims incurred but not reported, and changes in reserves for loss adjustment expenses.

The insurance company then deducts from its premium income these "losses" as if they had been paid. The company compares these incurred losses to the premium income to determine the loss ratio. But, the fact, this money is not only not lost but it is out at investment earning money, not for the insureds who supplies this money, but for the insurance company who has already deducted it as if it were paid out.

It is important to understand this before any changes in the fabric of American society are wrought at the insistence of instigation of the casualty insurance industry.

The insurance industry, during the early and middle 1970's, fabricated a medical malpractice crisis by showing substantial losses and by increasing very substantially the premiums charged to doctors and other health care providers.

The doctors responded by withholding services in some areas and by demanding "tort reform" in all areas. The legislatures of virtually all states responded with some shifting of the burden from the malpractitioner to the victim.

However, there were other results as well. One was the requirement that Medical Malpractice be reported as a separate line of insurance, no longer reported as part of General Liability. This act has provided the information which allows the retrospective view of the "crisis," presented earlier in this statement.

Another result was the inspiration which led to the establishment of a variety of professional association "self insurance" schemes. We have included some clippings from the articles written about their success.

The Department of Commerce should be congratulated for pursuing the principle of self-insurance or risk retention to the extent that these hearings today have resulted.

What have we learned that leads us to endorse this legislative proposal? Why do we believe that this principle of Risk Retention will defuse this "crisis" and help to deter the next?

Because we are denied the opportunity to properly evalate product liability insurance we must return to the general principles of insurance.

Can an association insurance program reduce premiums? Yes. In 1978, St. Paul Fire and Marine Insurance Company had commission and brokerage expenses of $194 million. This constituted 44 percent of the total expenses paid or 17 percent of the net earned premiums. Commission and brokerage are obviously not the only acquisition costs. It is clear that any association or risk retention group can avoid virtually all acquisition costs for an immediate substantial savings. The expense load should be very substantially reduced for all other expenses as well.

The only expense line that should parallel the commercial insurer is the loss adjustment expense and this is included in the loss and loss adjustment incurred figures.

The surplus necessary to satisfy the solvency requirements should increase at a rate equal to inflation but in any event it need not be indefinitely enhanced in order to allow the expansion of the insurance business. A captive need not seek the same lofty financial pinnacles to which a good appetitive profit seeking commercial insurer aspires.

Finally, the assets of the risk retention group which are out at investment can be used to reduce the required amount of reserve nourishment needed from each premium dollar collected. Premiums, by all logic and reason, must be lower in a non-profit reciprocal or mutual insurance company created for a limited purpose.

The Association of Trial Lawyers of America believes firmly that the single most important contributing factor to the succession of "crises" the public has faced is the lack of information available as to the financial operation of the insurers. The reporting methods would give all the information required if the reports filed with the state insurance commissioners separated "Auto Liability" into its constituent parts, "General Liability" into its constituent parts, and "Multiple Peril" into its constituent parts.

The public should know what claims there are, for how much they are settled, and how much the premium income is, by line. Secrecy seems to be the greatest single weapon in the insurance industry arsenal in their war on human rights, which rights they find so inconvenient. "Truth in insurance" must precede any efforts to restructure the relationship of human beings to other human beings.

We refer to the Risk Retention Act as one of several "safety valve" mechanisms. They address the problems of availability and affordability. The problems are related to each other. They are also related to both the normal cyclical patterns of underwriting liability insurance and to the "panic-pricing" which the insurance industry has turned to in the recent past. We read that product liability premiums are stabilized at present. We even hear that they are declining. We know a little bit about insurance cycles, however, and we are coming to realize that those cycles can be, and are, manipulated. With no cause at all an outrageous across-the-board round of rate hikes can occur tomorrow, if the insurance industry chooses to make it happen.

Without safety valves such as the Risk Retention Act and Tax Equity, there is little to deter the casualty insurance industry from again pumping into the closed system the steam-pressure of unaffordability and unavailability. All they have to do is cry "liability explosion", publish a few more "lawn-mower" cases and declare a couple of hundred percent rate hike. They know that something will have to give and that their clients, the manufacturers, distributors, and sellers who are paying the premiums, can be depended on to help make it give.

Further, things are not as low-pressured right now as the opponents of Risk Retention might have the Congress believe. If it is asserted by those who would reject the Act that it is not needed because the commercial product liability insurance market has stabilized since the "crisis", and even that premiums are being reduced, let the discussion turn to deductibles. There is some reason to believe that what stability the insurance industry has deemed to restore to the market may well have been achieved by forcing its beleaguered policyholders to assume tremendous deductibles and to retain tremendous risk, all under the same specious doom-saying that supported the "panic-pricing" of recent years. It is all designed to keep premiums up, risk down, reserves full, and surplus skyrocketing. It also permits the insurance industry to keep its hands on the steam valve; to give it a spin when a little more pressure is needed for the "tort reform" drive.

Today, then, with the exception of some locales and some industries, we do have a relatively cool system. It remains, however, a closed system, ripe for pressurization. The enactment of the Risk Retention Act (and Tax Equity) would permit the system to be opened, when it needs to be open. Some industries could use Risk Retention right away, to finally "valve off" the pressure of recent years without almost "going bare". Others could find solace, and bargaining power, in the mere existence of that additional alternative when the rate hikes return.

The important thing is to do it now, to be prepared for the next cycle, or even to deter the next round of manipulation by the casualty insurers.

Everything about the Risk Retention Act commends itself to this Committee and to the Senate for favorable action. It is solidly conceived and drafted. It is restrained. It is accurately directed, offering the most help to those who need it the most, small businesses. It offers a self-help solution with built-in incentives to make it work. As passed by the House, it has a "sunset" provision which can be invoked if all the cries of "unnecessary, unwanted, and not useful" are, in fact, well-founded. It squarely addresses an insurance problem with an insurance solution and avoids that pitfall, so tempting to those backed up to a wall by the insurance industry, of letting the innocent victims of defective machines and products suffer without recourse to the just compensation due them.

Perhaps most telling is the roster of opponents to the Act. From the very beginning of the Product Liability Task Force's consideration of the Risk Retention Act, the opposition has been composed almost entirely of the organized casualty insurance industry. We do understand that there are some individual companies which have taken the enlightened step of endorsing the Act, but the insurance associations stand unanimously against it. Most to their arguments are couched in the language of concern for the public interest, and in terms of fear of Federal regulation or intervention.

We believe that the insurance industry's absolute terror of a little Federal illumination in its ever-growing underworld of influence, ownership, and power is highly justified. There is also no reason, other than the pursuit of the public interest, why the industry should not fight fiercely, as it has, any infusion of real competition in its sphere of operations. Further, it is our fondest wish that there is some truth in the prediction of this industry which has made itself the unchallenged authority on the abrogation of human rights that enactment of the Risk Retention Act "will delay or prevent enactment of tort reform legislation." We are not entirely surprised, either, to see that the industry goes on to describe "tort reform" as "the most effective solution to the product liability problem," even in the face of repeated reports that its spokeman admit that they do not know whether any "tort reform" proposal, passed or pending, will have the slightest effect on product liability rates; nor could they.

The arguments of the insurance industry against the Risk Retention Act are not, in fact, made in the interest of the public but are made in the most vulgar self-interest. The public, to include every segment of it interested in the product liability problem except the insurance industry, has spoken on this bill, and has done so with one voice in support. The Act will be used and is anxiously awaited to be used at this moment by frustrated, otherwise helpless premium payers. The insurance industry's statements to the contrary do not bear scrutiny. If no one is going to use the Act, then it will die under its own "sunset" provision. Why, then, this desperate effort to send it to an early death?

A truly enlightened insurance industry would in its own self-interest support this legislation. The very limited aspect wherein the Federal government would allow the operation of these companies would relieve the pressure which is building to repeal the McCarran-Ferguson Act, to produce Federal regulation of insurance. In that respect, Risk Retention is also a relief valve for the insurance industry and for those who wish to see insurance regulated by the States.

We applaud the efforts of this Committee to resolve the needs of the insurance consumer in the face of the intractible and intransigent casualty insurance industry. We believe the future will show to your satisfaction how out of step is the insurance industry in its opposition to your proposed legislation.

I will be happy to respond to any questions you may have, to the extent that I am able, and I offer you the resources of the membership and staff of the Association of Trial Lawyers of America if that might be in any way useful.

Senator STEVENSON. Mr. Urbanski?

Mr. URBANSKI. Thank you, Mr. Chairman. I would like to briefly read part of my testimony, and then make some observations on today's testimony.

My name is Curtis G. Urbanski. I am president of American Insurance Marketing Corp. My testimony is submitted on behalf of myself alone, albeit with the encouragement of three insurance industry associations. It is submitted solely for the purpose of informing the committee about the practicalities of developing and managing association and industry group insurance and risk retention programs.

The corporation I am employed by, American Insurance Marketing Corp., is a company organized and owned by the leading independent insurance agencies in all major trade areas throughout North America. It was organized approximately 12 years ago for one specific purpose:

To research and develop association insurance programs. These programs in part include both property liability, product liability, life, health, and formalized self-insurance programs.

Basically, our affiliates on their own, along with ourselves do association oriented programs. Our affiliates do programs on an individual basis for individual businesses outside of associations, also.

Most of our people are all oriented to that association insurance market and have been for some time.

On my level we service among others, clients such as real estate brokers, electronic service dealers, beer and wine distributors, nursing homes, aviation companies, et cetera.

During my 7 specific specialized years, beyond my other years in insurance, I have come to recognize certain points of dealing with association business. Those observations are:

One, perceived needs normally receive more attention than actual needs.

Two, most members of a group responding to a survey promising cost savings through a new sponsored insurance program will respond positively to the idea.

Three, most members cannot furnish a comprehensive history of premiums and losses.

Four, many association elected officers are motivated by a need for recognition.

Five, very few members are willing to admit their loss experience is bad.

Six, very few members will change substantially identical insurance portfolios for less than a 10-percent premium savings.

Seven, very few members are willing to accept the additional cost of special safety engineering.

Eight, above all else, group programs succeed because of the affinity of the group members.

In 1976 as a consequence of poor loss history over a number of years, and the tight insurance market in 1975 and 1976, a client of AIM's, my corporation, was forced to seek an alternative to the standard insurance marketplace.

The National Welding Supply Association, which I might add is a member of the National Association of Wholesalers and Distributors, had been a client of AIM's since 1971. But after notification of cancellation by Providence-Washington Insurance Group in the summer of 1976, it was difficult to find a new carrier willing to undertake the program.

After contact with 50 domestic insurance carriers, both admitted and surplus lines, a decision was made in October of 1976, with the encouragement of AIM, to form an industry-owned captive insurance company to insure NWSA members for products, property, automobile, general liability, and crime coverages.

With the knowledge that over 100 welding supply distributors could be without coverage on January 1, 1977, a steering committee of NWSA members was formed at a special Chicago meeting called by NWSA to discuss the current industry insurance problem. It was the job of this committee to rally and marshal support for the captive measure, plus guide the formation process being managed by AIM and the captive management company recruited by AIM.

After four formation meetings held throughtout the country for NWSA members, two steering committee meetings, and various mail surveys, a plan of action was formulated:

Members of the welding supply industry, not NWSA, would capitalize a Colorado association captive insurance company with over $1 million of contributed capital.

In exhibit A and exhibit J to my testimony,[1] you will note both the structure of that company that was formed.

This company, known as WESCAP was formed with the help of the Colorado insurance commissioner and the Colorado attorney general in less than 1 month during the month of December 1976.

Its initial capitalization of $1,100,000 was raised during the month of November 1976 and deposited in a trust account in Philadelphia, Pa.

On December 30, 1976, WESCAP was given a charter as the first association captive under the Colorado captive law.

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[1] All of the exhibits are in the committee files.

I might add in a memorandum of January 29, 1980, by Mr. Schwartz, and the counsel from the Task Force on Product Liability to the General Counsel of the Commerce Department, was totally incorrect in stating on page 13 that there were no, as of December 1978, association captives formed in Colorado. Two years before that, obviously WESCAP had been formed.

WESCAP Insurance Co., acts as a captive reinsurance company reinsuring the policies of a standard, admitted, A-rated insurance company. Through the use of this policy-issuing company, members receive the same financial stability of a large company plus WESCAP is able to function in all 50 States.

Policyholders are protected by State guaranty funds paid through the policy-issuing company. WESCAP, because of its adequate capitalization, was able also to protect itself through the purchase of various reinsurance agreements. After its first year of operation, WESCAP was insuring over 10 percent of the NWSA membership.

What this experience brings as a challenge to the enactment of the Risk Rentention Act is this:

One, mechanisms currently exist for resolving the product liability or any other insurance problem—which is not being addressed here. But those may also come up in the future—based on availability or affordability.

Two, time and State insurance regulations are not obstacles to formation of domestic captive insurance companies.

We researched the possibility of forming it offshore. We, at first, thought it would be more difficult to form it in Colorado. It became easier to do it in Colorado than to do it in Bermuda.

Three, capitalization of a domestic captive insurance company is not an obstacle if an industry truly has a problem, and has the widespread support to resolve it.

Four, current obstacles for domestic captive insurance companies are created by current Federal bodies; namely, the Securities and Exchange Commission with regard to capital formation and the Internal Revenue Service with regard to deductibility and income tax liabilities.

Five, numerous industries have or are considering forming captive insurance companies, or rent-a-captive schemes.

My exhibits B through H indicate a numbers of those associations.

Six, states other than Colorado have enacted or have considered captive insurance legislation, including Tennessee, Virginia, Nebraska, Minnesota, Washington, et cetera.

I, myself, have a copy of the legislation being considered in Nebraska, and have been out there at least one time in 1977, when that was being formulated. I met with the insurance commissioner's department.

If the Risk Retention Act is enacted, the problems of group action or inaction still remain:

One, how to raise capital equitably and legally.

Two, how to determine rates equitably and legally.

Three, how to accommodate large and small members.

Four, how to cope with the problem of nonhomogeneity of members.

Five, how to protect the consumer and the members if a pooling is inadequately capitalized or premiums are insufficient.

Six, how to afford the expenses of Federal regulations if only a small number of poolings are formed.

I refer to exhibit I.

Members of the comittee, my point in this testimony is as I said in the beginning, to look at this legislation from a practical viewpoint; to look at the world as it actually operates and exists today; to look at it from the perspective of one who has confronted the problem and found a solution.

Any action either for or against this legislation must not be taken from a theoretical viewpoint. Practical answers must be found for such questions as:

Will industry groups with small capitalization be able to purchase adequate reinsurance and efficiently cover fixed costs of regulation and management?

Is this problem an ongoing problem that members will consistently support risk pooling or a captive as a solution?

How will pools that are to be disbanded cover the long product liability tail of claims.

Is the Risk Retention Act a long-term solution to a short-term problem?

Answers to these and many other questions must be answered before this legislation should proceed. Any less attention would be embarrassing. Any less attention could be costly to both industry members and consumers.

I might add, I am embarrassed both for the insurance industry and its representatives, albeit that at least two of them may have some general knowledge of the subject, and also, the Federal agencies that have testified and some of the trade groups that testified. It was noted that there are "45 States that say you cannot do association programs" is baloney. We have been doing this for 12 years, as have a number of other people.

A number of points were brought up about rating. Some of the problems of rating, obviously are caused by the problem in the tort area. The only reaction to that, is that the way rates are generated, obviously, is due to a uniqueness of product. It is very difficult to say that every product should be the same, because no industry is completely homogeneous. We, ourselves, in the WESCAP company had to find within that industry five different types of distributors and were able to, after 1 whole day's exhausting interrogation and meeting with the steering committee of WESCAP, finally came up with a rating structure to use.

There are a number of other items that I won't burden the committee with. I would be happy to respond to any questions that may be asked in regard to any of the testimony, because I do feel there is a considerable lack of knowledge about my area of the business.

Senator Stevenson. Thank you very much.

Our next witnesses are Mr. Lyndon Olson, chairman of the products liability task force NAIC, and Mr. Jerome Gordon, special assistant to the insurance commissioner of New Jersey.

Mr. Olson, I trust I don't need to repeat my admonition.

STATEMENTS OF LYNDON OLSON, JR., CHAIRMAN OF PRODUCTS LIABILITY TASK FORCE, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS; AND JEROME GORDON, SPECIAL ASSISTANT TO THE INSURANCE COMMISSIONER, STATE OF NEW JERSEY

Mr. OLSON. Senator, we have just finished holding rate hearings in Austin for about 12 long hours, and I now know how that poor sucker felt when we got to him.

Mr. Chairman, on behalf of the National Association of Insurance Commissioners, let me express our appreciation for the opportunity to testify on the Products Liability Risk Retention Act. May I add, my statement here today as chairman of the NAIC task force on products liability will be supplemented for the record. Copies of our November 30, 1979 statement before the House Subcommittee on Consumer Protection and Finance, as I understand it, have been made available to you.

Let me briefly say, the National Association of Insurance Commissioners is an association representing the State insurance regulatory officials of the 50 States and U.S. possessions and territories. Our decisions are reached by consensus at open meetings by votes of the officials representing each of the States.

Let me begin by saying to you and the representatives of business here today that I am concerned about the problems faced by small- and medium-sized businesses in our country today. I am concerned for the health of their business and as a result the health of our Nation. I am, as a regulator and a representative of the NAIC, most concerned about the effect of our actions and those of the insurance industry we regulate on these businesses.

As a former legislator from Texas, I am also acutely aware of your position as members of this committee on the need to evaluate fairly and adequately the proposal before you. The study of the product liability problems we face were begun by the Department of Commerce and by the States through the NAIC before I joined the Texas Insurance Department. But I am aware of the history that brings us here today and I want to highlight to you some of the salient points that I think have to be discussed and to some degree already have been.

Three primary causes of the product liability insurance problem have been identified: Insurance ratemaking practices, tort law, and unsafe products. Again, I will not cite all the groups that have drawn this conclusion. But we in the NAIC long ago agreed that improvements could be made in ratemaking procedures for this line of insurance. And we have worked to improve these procedures in our data base.

As of this year, product liability data will be separately collected in the annual statements. The insurance service office commercial statistical plan has been vastly improved, and we are now working on a uniform reporting form for 18 States that have insurance reporting statutes.

But in looking at ratemaking practices of the insurance industry and in examining some of the jumps that were reported today in product liability rates, we also have to look at history. The facts are that prior to the 1970's, product liability coverage was less than adequately priced. That's because it was infrequently used. It was giveaway coverage in a general liability package.

And although ratemaking practices can always be refined and improved, however, to label the loss distribution system as the culprit of the product liability insurance problem would be to characterize the symptoms of the disease as its cause.

The proponents of the Product Liability Risk Retention Act on the floor of Congress have said that this act will improve ratemaking practices. These practices have already been improved and this act in no way promotes or hinders those improvements.

Will the Products Liability Risk Retention Act affect or greatly reduce costs to businesses? And is the act needed to produce this effect? I think the answer to both of these questions is "no".

Title I allows pooling of all or a portion of a group's product liability and completed operations exposure. We are told that this section of the act will be primarily for first level retention or deductible of businesses. For this individual business pays a premium to the pool, an assessment to the Department of Commerce for administering the act, and State premium taxes in the State where they operate. So does this act cut cost directly to the individual business or raise expectations to an unreasonable level? I believe it raises unreasonable expectations without reducing insurance costs.

And if the group becomes insolvent as a result of many claims, mismanagement, poor investments, each of the individual members of the group still remain primarily liable for their product liability claims. There is no guaranty fund to go for payment; there are simply the assets of each individual company. Will businesses find themselves paying into a risk retention group, and when they have claims, still paying for those claims from assets? I believe businesses will end up paying on both ends of this risk distribution scheme.

Title II allows group purchase of product liability insurance by preempting State restrictions in this area. Let me say, Senator, that I am not adverse to examining true impediments to group purchase of insurance. If there are barriers that serve no legitimate purpose, I am willing and fully intend, as chairman of the NAIC task force on products liability, to recommend changes where they are prudent for all parties involved.

I should add, so my remarks are not misconstrued, that State consumer protections, such as capital and surplus requirements, guaranty funds, timely claims payment statutes, and the like, are unlikely to fall by the wayside from such a review. However, fictitious group laws could and should be examined.

But the point to be made here today is that if group purchase of insurance is the cost reduction method proposed by title II, then the Products Liability Risk Retention Act is not needed to accomplish that. State legislatures can address impediments to group insurance without Federal assistance.

Before I close this section of my statement, let me express one other concern that I have with the Department of Commerce's analysis of State requirements for formation of various insurance entities. In their analysis the DOC has taken an arm's length approach. The Department simply read the law. And as you know, the law and its interpretations and implementation are two separate issues. Today, for instance, I sit here while the U.S. Civil

Rights Commission is in Texas on a routine matter analyzing our regulations and practices on complaint handling and unfair discrimination. We in Texas will sit down with HEW to discuss such things as medicare supplement insurance.

But at no time am I aware that the Department of Commerce actually approached a State or the NAIC to determine how laws are implemented.

In the area of consumer protection, I'd like to emphasize a great deal of concern. It's another area where I question the positions, though not the good intentions, of those representatives before you today. Business wants lower costs. Consumers want claims paid. And I assume the trial bar wants another source for claims payment for their clients.

All of these positions are perhaps understandable when taken alone, but when you look at the three causes I cited at the beginning of my statement they become a bit surprising.

The very measures that are attacked by the Products Liability Risk Retention Act and deleted from it—capital and surplus requirements, guaranty funds, timely claims payment statutes—are regulations which protect the consumer. State regulation for solvency is State regulation for consumer protection. These mechanisms assure payment—and timely payment—of claims. If this act is absent such measures, how is it that proponents can say that this measure assures payments of claims or protects consumer interests?

But I am even more frustrated by the conflicting attitudes of the Federal Government toward State insurance regulation that this act creates. As the members of this committee are well aware, State insurance commissioners have been analyzed and criticized for too little regulation by congressional committees, the GAO, the FTC, and others. Here today we are criticized for too much regulation by the Department of Commerce. Who are we to believe in the Federal Government?

In fact, I think the Department of Commerce would simply rather duplicate a system than work with State regulators to determine how the system does work and what can be done to make it work better.

I might just point out, Senator, in closing, that Congressman LaFalce made an interesting observation this morning regarding reality and the perception of reality. I would respectfully submit to you that the reality is that ratemaking practices are a factor in the product liability problem, but not the sole cause. The perception of reality is that the Risk Retention Act solves this problem, although not by addressing ratemaking specifically. However, the act doesn't really solve ratemaking problems and consequently is a mere perception of reality.

I thank you very much, Senator, for your time.

[The statement follows:]

Statement on Behalf of the National Association of Insurance Commissioners, Submitted by Wesley J. Kinder, Insurance Commissioner of the State of California and President of the NAIC; and William H. L. Woodyard III, Insurance Commissioner of the State of Arkansas and Vice-President and Chairman of the Executive Committee of the NAIC; and Presented by Lyndon Olson, Jr., Member of the Texas State Board of Insurance and Chairman of the NAIC Task Force on Product Liability

Mr. Chairman, members of the Committee, we are submitting this statement on behalf of the National Association of Insurance Commissioners, a voluntary association of the principal insurance regulatory officials of the 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico and the Virgin Islands. Our association is the oldest association of state officials in existence today, originating in 1871, and is commonly known as the NAIC.

The objectives of the NAIC are (1) to promote uniformity in legislation affecting insurance, (2) to encourage uniformity in departmental rulings under the insurance laws of the several states, (3) to disseminate infomation of value to insurance supervisory officials in the performance of their duties, (4) to establish means to fully protect the interest of insurance policyholders, and (5) to preserve to the several states and United States possessions the regulation of the business of insurance. To achieve these purposes, the NAIC utilizes an extensive committee system and has permanent staff located in two offices.

On behalf of the NAIC, we wish to express our appreciation for the opportunity to comment upon the Product Liability Risk Retention Act of 1980 (PLRRA). Our remarks will be directed at the provisions of that Act and the impact they will have on product liability insurance problems. We will also specifically address the response of the Department of Commerce Task Force on Product Liability and Accident Compensation to our statement of November 30, 1979 to the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce. We hope this statement will assist the Senate Commerce Committee in developing a healthy skepticism toward the alleged benefits of the PLRRA.

I. NATURE OF THE PRODUCT LIABILITY INSURANCE PROBLEM

A great deal of attention has recently been given to problems affecting the product liability insurance market. The Federal Interagency Task Force on Product Liability produced a massive report on the nature and scope of product liability problems in January 1977.[1] In addition, a number of congressional committees have gathered testimony on problems surrounding product liability and product liability insurance.[2] Some of this testimony was aptly summarized in a report of the Subcommittee on Capital, Investment, and Business Opportunities of the House Committee on Small Business on March 21, 1978.[3] While the NAIC generally concurs with the findings of these federal investigations, the NAIC does not agree that the product liability insurance problem has been properly characterized nor that proper emphasis has been given to certain causes of the problem .

A. THE PROBLEM OF "AFFORDABLE" PRODUCT LIABILITY INSURANCE

In describing the nature of the product liability insurance problem, the Department of Commerce recently observed that "Administration, congressional, and state studies show that the heart of the problem is affordability, not availability, of coverage."[4] Although this assessment of the nature of product liability insurance problem is not incorrect, it is an unworkable characterization of the problem because the term "affordability" is nearly impossible to define. Determining the point at which escalating premiums become "unaffordable" is a purely subjective matter dependent on the individual judgment and circumstances of each insured. It is impossible for government institutions or other third parties to determine whether a particular premium quotation is or is not "affordable". Evidence uncovered by the Federal Interagency Task Force on Product Liability reveals that "[t]he average cost of product liability insurance is less than 1 percent of sales in most of the Task Force's target industries, but it is higher for some manufacturers."[5] The NAIC seriously questions whether product liability insurance premiums can be labeled "unaffordable" when they represent such a small percentage of sales. Certainly, premiums for product liability insurance are no less "affordable" to product manufacturers and businesses than automobile insurance premiums are to the average American citizen. To use the term "affordability" in describing the product liability insurance problem, therefore, is to frame the issue in terms which defy proper analysis and prevent the development of appropriate remedies.

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[1] *See* FEDERAL INTERAGENCY TASK FORCE ON PRODUCT LIABILITY, FINAL REPORT (1978).

[2] *E.g.*, *Hearings on Product Liability Problems Affecting Small Business Before the Senate Select Comm. on Small Business*, 94th Cong., 2d Sess. (1976); *Hearings on Product Liability Insurance Before the Subcomm. on Capitol, Investment and Business Opportunities of the House Comm. on Small Business*, 95th Cong., 1st Sess. (1977); *Hearings on S.403 Before the Subcomm. for Consumers of the Senate Comm. on Commerce, Science and Transportation.*, 95th Cong., 1st Sess. (1977).

[3] *See* H.R. REP. NO. 95-997, 95th Cong., 2d Sess. (1978).

[4] U.S. DEP'T OF COMMERCE, PRODUCT LIABILITY RISK RETENTION ACT OF 1979 – BACKGROUND PAPER 3 (Aug. 16, 1979).

Although it is not inaccurate to describe the product liability insurance problem as one of "affordability", the problem is better characterized as a sudden and dramatic escalation of product liability insurance premiums in the years 1975-77. This characterization of the problem eliminates the difficulties inherent in determining whether product liability insurance is "affordable" or "available" while still reflecting the problems encountered by manufacturers and businesses in obtaining product liability insurance. Moreover, by characterizing the product liability insurance problem as one of sudden and dramatic premium increases the problem is framed in terms which more accurately reflect the evidence collected during federal investigations of the problem. For instance, the House Subcommittee on Capital, Investment and Business Opportunities concluded that "many businesses have experienced significant product liability premium increases",[6] but found difficulty with the distinction between "affordability" and "availability" of insurance coverage.[7] We therefore believe that the problem surrounding product liability insurance for manufacturers and businesses can best be addressed by viewing the problem as a sudden and dramatic increase in premiums rather than the "unaffordability" of insurance coverage.

B. PRINCIPAL CAUSES OF THE PRODUCT LIABILITY INSURANCE PROBLEM

Having identified the product liability insurance "problem" has the sudden and dramatic escalation of product liability insurance premiums in the years 1975-77, the NAIC suggests that the proper issue for this Committee to consider is the question whether this dramatic rise of insurance premiums was justified. If it can be determined that the increase in insurance premiums during those years properly reflected the product liability risks assumed by the insurance industry, then solutions to the product liability insurance problem should be directed at the factors giving rise to high insurance costs. On the other hand, if the product liability insurance premiums collected from manufacturers and businesses during the "crises" years of 1975-77 did not reflect the risk of loss associated with product liability risks, solutions to the product liability insurance problem should be aimed at the product liability insurance ratemaking process.

It is our belief that the sudden and dramatic increase in product liability premiums in the years 1975-77 was caused *primarily* by a significant increase in the risk of loss associated with product liability insurance coverages. The Federal Interagency Task Force on Product Liability has identified two specific factors which increased the risk of loss connected with product liability insurance policies: manufacturing practices and the tort-litigation system.[8] We concur that these two factors played a significant role in increasing the risk of loss assumed under product liability insurance policies. To the extent little or no emphasis is placed on loss prevention programs there is a greater likelihood that product defects will go undetected and cause product-related injuries. Similarly, the growing willingness of appellate courts to allow recoveries for product-related injuries significantly increases the likelihood that losses will be sustained under product liability insurance policies. While both of these factors contribute to an increase in the risk of loss assumed under product liability insurance policies, they do not, by themselves, explain the sudden and dramatic rise in product liability insurance premiums in the years 1975-77. We believe three additional factors combined with manufacturing practices and the tort-litigation system to produce a significant increase in the risk of loss assumed under product liability policies in the years 1975-77.

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[5] FINAL REPORT, *supra* note 1, at xxxvii.

[6] H.R. REP. NO. 95-977, *supra* note 3, at 70.

[7] *Id.* at 10.

[8] FINAL REPORT, *supra* note 1, at xxxix-xliv.

1. The Increasing Tendency to Sue

One factor which contributed to a substantial escalation in product liability risks in the years 1975-77 was the unfolding of a new era in personal injury lawsuits. Although the Federal Interagency Task Force on Product Liability concluded that "[d]ata are not available that would provide a firm indication of trends in the number of product liability claims in the 1974-1976 period",[9] the Task Force went on to point out that in the target industries selected for review "the average number of pending claims appears to have increased substantially between 1971 and 1976."[10] This finding is supported by statistics compiled by the Task Force from federal court dockets which indicate "an unquestionable increase in the number of product liability lawsuits being filed" for the period 1974-76.[11] The specific claims and lawsuit data produced by the Federal Interagency Task Force on Product Liability is further supported by findings of the California Citizens Commission on Tort Reform that lawsuits, other than those related to automobile accidents, grew at a rate "sometimes as fast as 13 times the rate of population growth" of California during the years 1975-76.[12] The growing tendency of the American public to file personal injury lawsuits during the early 1970's greatly increased the likelihood that losses would be sustained and expenses incurred in connection with product liability lawsuits. This greater likelihood of a risk of loss contributed to the substantial increase in rates charged for product liability insurance policies during the years 1975-77.

It is surprising that the Commerce Department does not agree that available data supports the conclusion that there was a growing tendency of the American public to file lawsuits during the early decade of the 70's. The basis of this NAIC conclusion was a direct quotation from the final report of the Federal Interagency Task Force on Product Liability, a Task Force under the direction of the Department of Commerce. If the NAIC conclusion regarding trends in product liability claims and lawsuits is inaccurate, the responsibility for this inaccuracy lies with the Department of Commerce and not the NAIC. Furthermore, the Department of Commerce cites the product liability closed claim survey of the Insurance Services Office (ISO) as evidence refuting the NAIC conclusion that a growing number of product liability claims were filed in the years 1971-76.[13] ISO has clearly stated, however, that its closed claims survey is simply a "snapshot" view of the product liability situation at a single point in time.[14] As a result, data from the ISO closed claim survey can neither support nor refute conclusions about trends in product liability claims or lawsuits. Despite the contrary views of the Department of Commerce, the NAIC continues to believe that a growing tendency on the part of the American public to file personal injury claims and lawsuits was an important factor in the dramatic escalation of product liability insurance premiums in the years 1975-77.

2. Inflation

A second factor which contributed to the dramatic escalation of product liability premiums in the years 1975-77 was the severe impact of double-digit inflation on the cost of goods and services purchased with product liability insurance premium dollars. The inflation rate in the years 1974-76 greatly influenced the rates charged for policies written in the years 1975-77.[15] Although it is true, as the Department of Commerce notes, the Consumer Price Index reached a double-digit level only once during the period 1974-76,[16] the Consumer Price Index is not the only indicator of the purchasing power of the product liability insurance premium dollar. Because the largest share of the product liability premium dollar is used to pay bodily injury claims,[17] the cost of medical care probably provides a better estimate of the impact of inflation on product liability premiums than the Consumer Price Index. During the years 1974-76 the medical care price index increased an average of 10.3% per year, compared to an average of 4.5% per year for the years 1971-73.[18] Despite the Commerce Department's assertion that double-digit inflation does not explain the dramatic rise in product liability premiums in the years 1975-77, the NAIC continues to believe that inflation played an important role in the dramatic rise in product liability insurance rates during those years.

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[9] Id. at VI - 55.

[10] Id.

[11] Id. at VI - 57 — VI - 58.

[12] CALIFORNIA CITIZEN'S COMMISSION ON TORT REFORM, RIGHTING THE LIABILITY BALANCE 6 (1977).

[13] U.S. DEP'T OF COMMERCE TASK FORCE ON PRODUCT LIABILITY & ACCIDENT COMPENSATION, RESPONSE TO STATEMENT ON BEHALF OF THE NAIC REGARDING THE PLRRA 4 (Jan. 29, 1980) [hereinafter cited as DOC RESPONSE].

[14] INSURANCE SERVICES OFFICE, PRODUCT LIABILITY CLOSED CLAIM SURVEY: A TECHNICAL ANALYSIS OF SURVEY RESULTS 7 (1977).

3. Conditions in the Property/Casualty Insurance Market

A third factor which helps explain why product liability premiums increased so dramatically in the years 1975-77 was the general condition of the property/casualty insurance market at that time. The years 1974 and 1975 have been described as "underwriting and investment disasters for the property and casualty insurance business unparalleled since the 1930's, if ever."[19] Observers explain that "inflation and recession occurring together for an extended period of time . . . destroyed the comfort derived by insurance managements and insurance regulators from the familiar stabilizing effect of the alternating economic swings in underwriting and investment results."[20] Faced with the necessity of insuring only those risks which could be counted on to return a reasonable profit, insurance executives in 1975 and 1976 began to reallocate limited capital and corporate resources away from product liability risks.[21] The inevitable result of this classic economic decision-making was a shrinking of market capacity for product liability risks and a concomitant increase in insurance costs for manufacturers and businesses.[22]

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15. The inflation rate for the year 1974, for example, influences insurance rate calculations for policies written in the year 1975. Inflation during the period 1974-76 is therefore an important factor in insurance rate calculations for the years 1975-77.

16. DOC RESPONSE, supra note 13, at 3 n.2.

17. A review of 24,452 product liability claims from the ISO closed claim data base indicated that the average bodily injury payment per product liability incident was $26,004, while the average property damage payment per product liability incident was only $6,871. The percentage of the product liability premium dollar used to pay bodily injury claims is approximately four times the percentage of the premium dollar used to pay property damage claims. ISO SURVEY RESULTS, supra note 14, at 11.
18. U.S. D
18. U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 103 (1979).

19. R. Roddis & R. Stewart, The Insurance of Medical Losses, 1975 DUKE L. J. 1281, 1288.

20. Id.

21. D. Brummond, A Comparison of the Product Liability and Medical Malpractice Problems, I NAIC PROCEEDINGS 774, 782 (1977); U.S. DEP'T OF COMMERCE, INTERAGENCY WORKING TASK FORCE ON PRODUCTS LIABILITY, SYMPOSIUM ON PRODUCTS LIABILITY 172 (July 21, 1976) (Remarks of Mr. Richard Marcus).

22. D. Brummond, supra note 21, at 782.

C. INSURANCE RATEMAKING PRACTICES

Although the primary cause of the dramatic escalation of product liability insurance premiums in the years 1975-77 was factors affecting the underlying cost of insurance, product liability insurance ratemaking practices likewise contributed to the dramatic escalation in premiums. Because of the heterogeneous nature of product liability risks, the inclusion of product risks in "package policies", and the tremendous number and diversity of products subject to liability claims, the product liability insurance ratemaking process is fraught with uncertainties and heavily dependent on the subjective judgment of insurance underwriters.[23] The combination of ratemaking uncertainties and subjective judgment led to a certain amount of "panic pricing" in the years 1975-77.[24] In some cases insurance underwriters may have overreacted to the growing litigiousness of the American public, double-digit inflation, the liberalization of tort liability standards and unsafe manufacturing practices by establishing rates which reflected an unreasonably high product liability risk for certain manufacturers and businesses.

While it is true that some product liability rates during the 1975-77 period may have represented an unreasonably high assessment of product liability risks, the NAIC does not believe that insurance ratemaking practices were a "principal" cause of the dramatic rise in product liability premiums during those years. It is true that the insurance industry has been largely unable to "justify" dramatic increases in product liability rates with objective data. This does not mean, however, that product liability rates as a whole are not reflective of underlying product liability risks. The subjective nature of the ratemaking process, by definition, makes it difficult to "justify" particular rates with objective data. Statistics from the NAIC Statistical Reporting System indicate, however, that countrywide loss ratios for commerical multiple peril and general liability policies — policies insuring product liability risks, among other risks — fell within reasonable bounds during the years 1975-77.[25] While these statistics do not precisely prove that product liability rates for the period 1975-77 actually reflected the loss experience which developed from policies written in those years, they provide enough information to support the conclusion that the rating practices of the industry as a whole generally reflected losses experienced from product liability risks in the years 1975-77. Thus, we cannot concur with the conclusion that insurance ratemaking practices were a "principal" cause of the dramatic rise in product liability premiums in the years 1975-77.

Because of the uncertainties surrounding the product liability insurance ratemaking process it is possible that the severe premium increases of the years 1975-77 may occur again if remedial measures are not taken to reduce these uncertainties. To prevent widespread "panic pricing" on the part of the industry if such conditions are repeated, the NAIC and individual states have recently taken steps to minimize the subjectivity and uncertainty that is found in the product liability insurance ratemaking process. These steps basically involve improving the availability of specific product liability premium and loss data. One step the NAIC has taken has been to review improvements in the Commercial Statistical Plan of ISO to determine whether such improvements will enhance the data base used in the calculation of product liability insurance rates. The implementation of separate reporting requirements for multi-line policies and the incorporation of the composite rating rule in the Commercial Statistical Plan are examples of recent initiatives to improve the Commercial Statistical Plan which will enhance the availability of product liability premium and loss data. In addition, the product liability supplement to the NAIC Annual Statement adopted by the NAIC in April 1979[26] will provide better information

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[23] *See Hearings on Product Liability Insurance Before the Subcomm. on Capital, Investment and Business Opportunities of the House Comm. on Small Business*, 95th Cong., 1st Sess. 856-58, 860 (1977) (Statement of Commissioner Lester Rawls on Behalf of the NAIC).

[24] *See id.* at 870 (Remarks of Commissioner Lester Rawls).

[25] Data from the NAIC Statistical Reporting System reveal the following countrywide loss ratios:

Year	Commercial Multiple Peril	Other Liability
1975	.56	.57
1976	.479	.483
1977	.457	.552

[26] II NAIC PROCEEDINGS 178-79 (1979).

about specific product liability premiums and losses. This information will provide insurance regulators with a clearer picture of product liability loss ratios and profits for purposes of reviewing the condition of the product liability insurance market. Finally, at least 18 individual states have promulgated product liability reporting statutes which will provide a new source of information about product liability premiums and losses.[27] We hope these steps will prove extremely helpful in reducing the element of uncertainty in the product liability ratemaking process and assisting insurance underwriters in adjusting product liability rates to actual, rather than perceived, market conditions.

D. CURRENT MARKET CONDITIONS

Market conditions in the property/casualty segment of the industry have stabilized since the troublesome years of 1974 and 1975. Although inflation continues to rage at double-digit levels, it is no longer a startling new phenomena. Insurance industry executives and underwriters have learned in recent years to better structure insurance operations to accommodate the consistent and almost predictable rise in the rate of inflation. Moreover, stock prices have recovered from the low levels of the mid-1970's and have remained relatively stable during the latter half of the decade. As a result, the severe strains placed on industry surplus in the years 1974 and 1975 have diminished, if not disappeared. This development has led to a loosening of restrictions on property/casualty underwriting and a general expansion of the capacity of the industry to accept product liability risks.

In its statement to the House Subcommittee on Consumer Protection and Finance on November 30, 1979 the NAIC told that congressional panel that "market conditions have stabilized in product liability and completed operations lines."[28] The NAIC believes its assessment of the condition of the product liability insurance market is still accurate today. Testimony from the Independent Insurance Agents of America to this Committee on April 22, 1980 indicates that product liability insurance is available at competitive rates.[29] A recent survey of corporate risk managers by the National Underwriter provides further evidence that product liability insurance is available at competitive rates.[30] Despite this and other evidence the Commerce Department recently maintained that "conditions in the product liability market are anything but stable."[31] To support its conclusion the Commerce Department reviewed testimony before the House Subcommittee on Consumer Protection and Finance and concluded that "no product sellers testified that their premiums, which in some industries have increased as much as several thousand percent in recent years, have been rolled back to the prior lower levels."[32] The "roll back" theory not only ignores the primary causes of the product liability insurance problem — underlying insurance costs — but is irrelevant to the question of market stability. Moreover, should the Carter Administration adopt the "roll back" theory of the Department of Commerce as the standard for judging economic stability, the NAIC fears the American economy as a whole would receive no better marks than the product liability insurance market. It is fortunate that this criteria for economic stability has not been expanded beyond the limited confines of the product liability insurance market.

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[27] These states include Arizona, Connecticut, Florida, Georgia, Idaho, Illinois, Kansas, Louisiana, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New York, North Carolina, North Dakota, and Oregon.

[28] Hearings on the Product Liability Risk Retention Act of 1979 Before the Subcomm. on Consumer Protection and Finance of the House Interstate and Foreign Commerce Committee, 96th Cong., 1st Sess. — (1979) (Statement of Texas Insurance Board Member Lyndon Olson, Jr. on Behalf of the NAIC).

[29] Hearings on the Product Liability Risk Retention Act Before the Senate Comm. on Commerce, Science and Transportation, 96th Cong., 2nd Sess. — (1980) (Statement of Mr. David Rowland).

[30] D. Katz, Product Liability Market Softens, National Underwriter, April 11, 1980 at 5.

[31] DOC RESPONSE, supra note 13, at 16.

[32] Id. at 15.

II. TITLE I OF THE PLRRA: A STUDY OF FALSE EXPECTATIONS

The PLRRA was developed by the Department of Commerce as a outgrowth of its participation in the Federal Interagency Task Force on Product Liability. The purpose of the PLRRA, according to a summary prepared by the Department of Commerce, is "to facilitate the ability of product sellers to: (1) establish risk retention groups; and (2) purchase product liability and completed operations insurance on a group basis." Title I of the Act allows product sellers to form "risk retention groups" to pool all or a portion of their product liability and completed operations risk exposure. These risk retention groups must be approved by the Secretary of Commerce, who will consider the groups' assets, management, loss prevention efforts, reserves, risk exposures and "other relevant factors" before issuing a "certificate of approval" to the group.

In its background paper accompanying the PLRRA the Department of Commerce projected that the Act would accomplish five specific objectives. These objectives included: (1) a reduction in insurance costs for some businesses, (2) the prompt payment of legally valid claims made by persons injured by products, (3) an increase in the specialized loss prevention services provided to members of risk retention groups, (4) greater competition among providers of product liability and completed operations insurance, and (5) a reduction in the outflow of capital and premiums to offshore jurisdictions.[33] We have little confidence, however, that the Act will accomplish any of the objectives outlined by the Department of Commerce. Unfortunately, the projections of the benefits of the PLRRA by the Department of Commerce have only raised false expectations about the capability of the Act to address product liability insurance problems.

A. THE PLRRA WILL NOT APPRECIABLY REDUCE INSURANCE COSTS

The PLRRA will not appreciably reduce insurance costs for manufacturers and businesses. The PLRRA does nothing to modify factors affecting the underlying cost of insurance. It does not improve the tort-liability system or the loss prevention programs of product manufacturers. The Act does not propose legislative remedies to inflation: neither general remedies to inflation nor specific remedies to the inflation of goods and services purchased with product liability premium dollars. Most importantly, the PLRRA offers no suggestions on how insurance ratemaking practices can be improved to better estimate the cost of insuring product liability risks. Even if it is assumed that insurance ratemaking practices are the "principal" cause of product liability insurance problems — which they are not — the PLRRA does nothing to improve ratemaking practices and thereby reduce insurance costs. To the extent the actual causes of the dramatic product liability insurance premium increases in the years 1975-77 are not addressed in the PLRRA there is little foundation to the claim that the PLRRA will appreciably reduce insurance costs, not even for some businesses or manufacturers.

B. THE PLRRA WILL NOT ENSURE PROMPT PAYMENT OF LEGALLY VALID CLAIMS

In addition to the claim that the PLRRA will reduce insurance costs, the Commerce Department alleges that the Act will "[e]nsure the prompt payment of legally valid claims made by persons injured by products."[34] We strongly disagree with this contention. Not only is the PLRRA deficient in protecting against insolvent risk retention groups, but the Commerce Department's own analysis of the PLRRA suggests that the likelihood of insolvencies is not an imaginary danger.

Because there are inadequate protections against the possibility that risk retention groups will become insolvent the PLRRA diminishes, not increases, the likelihood of prompt claim payments. The NAIC has previously noted and continues to maintain that the absence of specific capital and surplus requirements for risk retention groups poses a serious threat to the financial solidity of Title I groups. It is simply no answer to this criticism to say, as the Commerce Department argues, that the PLRRA "provides the Secretary of Commerce with appropriate regulatory authority to ensure that approved groups are adequately capitalized and managed."[35] Specific statutory requirements for capital and surplus are not the equivalent of broad discretionary authority. If the staff of the Department of Commerce believes it can advise the Secretary of Commerce as to proper levels of capital and surplus for risk retention groups, why can't such advice be incorporated into the Act itself as specific statutory standards? We fear that if the Congress grants the Secretary of Commerce broad discretion to determine proper capital and surplus levels for risk retention groups, the Secretary will be required to gain on-the-job training in insurance regulation at the expense of product liability claimants.

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[33] BACKGROUND PAPER, *supra* note 4, at 2.

[34] *Id.*

[35] DOC RESPONSE, *supra* note 13, at 12.

A second characteristic of the PLRRA which leads us to question the Act's capacity to prevent insolvencies is the absence of a guaranty fund mechanism. Even the best statutory standards for the financial solidity of insurance mechanisms and the most agressive regulatory oversight of the financial affairs of insurance institutions cannot guarantee that no insolvencies will, in fact, occur. For this reason guaranty fund mechanisms have been established in virtually every state to serve as a "safety valve" against the insolvency of insurance institutions.[36] The recent allegation of the Commerce Department that "[a] guaranty fund mechanism is not congruent with the risk retention concept"[37] is hard to understand. Not only does this allegation conflict with earlier views of the Department of Commerce on guaranty fund mechanisms,[38] but it violates sound cannons of public policy. The additional security a guaranty fund mechanism provides to potential product liability claimants unquestionably outways the "disincentives" the mechanism would create for manufacturers and businesses to form a risk retention group. Moreover, the fact that two state captive insurance statutes exempt state-regulated captives from guaranty fund participation[39] does not support the notion, as the Commerce Department maintains,[40] that the risk retention concept is incongruent with a guaranty fund mechanism. Not only are product liability risk retention groups more analagous to reciprocals, which participate in guaranty fund mechanisms,[41] than captive insurance companies, but the recent trend in captive insurance statutes is to subject risk sharing entities such as product liability risk retention groups to guaranty fund participation.[42]

A final reason supporting our belief that the PLRRA will diminish financial protections presently available to product liability claimants is the weakness of the analysis given by the Department of Commerce to the financial protections of the PLRRA. The Commerce Department has argued that the PLRRA will increase the probability that product liability claimants can enforce their judgments because many firms which now are uninsured will join risk retention groups under the PLRRA.[43] The fact that manufacturers and businesses who are currently uninsured may join risk retention groups does not answer criticism that risk retention groups *themselves* will be unable to pay product liability claims. A further argument of the Department of Commerce in support of the capacity of PLRRA to ensure payment of product liability claims is the observation that "some state regulation does not, in fact, protect potential claimants."[44] Not only is this observation totally irrelevant to the allegation that the PLRRA will ensure prompt payment of product liability claims, but it is completely unsubstantiated. Finally, the NAIC finds it extremely interesting that the Department of Commerce believes a guaranty fund mechanism underwritten by the federal government "could expose the taxpayers to a large potential liability."[45] Since the only source of this potential liability is the legal obligations of risk retention groups to pay product liability claims, we view this statement as an implicit admission that risk retention groups may not be able to meet their insurance obligations. While the NAIC applaudes the concern of the Department of Commerce for the taxpayers of the United States, we question the wisdom of a public policy which protects the liability of federal taxpayers at the expense of persons injured by defective products.

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[36] Oklahoma is the only state which has not established a property/casualty insurance guaranty fund mechanism.

[37] DOC RESPONSE, *supra* note 13, at 12.

[38] The Commerce Department suggested in its August 16, 1979 Background Paper on the PLRRA that possible participation of risk retention groups in state guaranty fund associations would "increase the probability that product liability claimants can enforce their judgments." BACKGROUND PAPER, *supra* note 4, at 5.

[39] *See* COLO. REV. STAT. § 10-6-127 (1976); TENN. CODE ANN. § 55-4527 (Supp. 1978).

[40] *See* DOC RESPONSE, *supra* note 13, at 13.

[41] *See, e.g.,* CAL. INS. CODE § 1281 (West 1973); COLO. REV. STAT. § 10-13-114 (1976); ILL. REV. STAT. ch. 73, § 697 (1976).

[42] The Virginia legislature recently enacted a bill which requires "association captive insurance companies" to participate in the state's guaranty fund association, but exempts "pure captive insurance companies" from participation. Ch. 665, § 38.1-875, 1980 Va. Acts – (Approved April 4, 1980). The Commerce Department has long contended that its product liability risk retention group is an "association captive."

[43] *Id.* at 5-6.

[44] U.S. DEP'T OF COMMERCE TASK FORCE ON PRODUCT LIABILITY AND ACCIDENT COMPENSATION, PRODUCT LIABILITY RISK RETENTION ACT OF 1979 – STATEMENT OF PURPOSE AND NEED 8 (Aug. 16, 1979).

C. THE PLRRA WILL NOT INCREASE SPECIALIZED LOSS PREVENTION SERVICES

In describing the benefits of the PLRRA the Commerce Department has alleged that the Act will "[i]ncrease the specialized loss prevention services provided to members of risk retention groups, thereby reducing injuries caused by products."[46] After reviewing the statutory provisions of the PLRRA and supporting documents submitted by the Commerce Department in conjunction with its original draft of the Act, we find no evidence that the PLRRA creates incentives for loss prevention services. The only support for this bold contention of the Department of Commerce is an oblique reference to the fact that the Federal Interagency Task Force on Product Liability found that "small businesses generally receive fewer loss prevention services than larger firms."[47] While this statement is probably true, it does not explain how or why the PLRRA will increase the availability of loss prevention services to manufacturers and businesses.

If a possible rationale for the claim that the PLRRA will create incentives for loss prevention services had to be surmised it would be the financial risk assumed by individual members of a risk retention group. Because individual participants of a risk retention group may be affected by the loss experience of other group participants if the "risk agreement" between the group and its members contains certain merit rating features, participants may have a financial incentive to reduce losses through loss prevention programs. The merit rating feature of a "risk agreement" is not a unique advantage of the PLRRA, however. Retrospective rating plans and merit rating techniques are currently available to most manufacturers and businesses under existing product liability insurance coverages. Furthermore, alternative risk sharing mechanisms such as mutual insurance companies and reciprocals offer the same incentives for loss prevention services as a risk retention group. Finally, if increasing the availability of loss prevention services to manufacturers and small businesses is a major objective of the proponents of the PLRRA, direct federal incentives would seem to be a better approach for encouraging the availability of loss prevention services than the PLRRA. Tax incentives, federal grants and direct federal programs are examples of techniques for encouraging the use of loss prevention services by manufacturers and small businesses which are more likely to accomplish intended results than the PLRRA. We simply cannot find any evidence that enactment of the PLRRA will increase the availability of specialized loss prevention services to manufacturers and small businesses who participate in risk retention groups.

D. THE PLRRA WILL NOT PROMOTE GREATER COMPETITION AMONG PRODUCT LIABILITY INSURERS

A fourth objective of the PLRRA, according to the Commerce Department, is to "[p]romote greater competition among providers of product liability and completed operations risk coverage. . . ."[48] It is a major premise of the Commerce Department that the PLRRA will increase competition in the product liability insurance market by allowing alternative risk sharing mechanisms to compete with private "commercial insurers". This premise is seriously flawed, however.

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[45] DOC RESPONSE, supra note 13, at 13.

[46] BACKGROUND PAPER, supra note 4, at 2.

[47] Id.

[48] STATEMENT OF PURPOSE AND NEED, supra note 44, at 3.

In the first place, there is little evidence to indicate a lack of competition in the product liability insurance market. Spokesmen for the insurance industry have testified before this Committee that hundreds of insurers are now actively competing in the product liability insurance market.[49] In addition, insurance regulators in a significant number of states have a statutory responsibility to review the level of competition in a given insurance market and take remedial action if a lack of competition exists.[50] The NAIC is unaware of a single instance where its members determined that such remedial action was necessary because of a lack of competition in the products liability insurance market. Consequently, the implication of the Commerce Department that the product liability insurance market is not currently competitive is unfounded. The need for an alternative risk sharing mechanism to enhance competition is therefore dubious.

A second deficiency in the premise of the Commerce Department that the PLRRA will inject an element of competition in the product liability insurance market arises from a basic misunderstanding of the insurance ratemaking process. Although never explicitly stated, the Commerce Department contemplates that risk retention groups will provide lower rates to individual participants if the participants have enjoyed a favorable claims experience in the past. This assumption is based upon the false notion that manufacturers and businesses with clean claim records are good risks which deserve lower insurance rates. The NAIC discussed this misperception about the nature of the insurance ratemaking process in testimony before the Senate Subcommittee on Citizens and Shareholders Rights on January 17, 1978:

> The proponents of merit-rating claim that the test of acceptability and goodness of a risk should be determined primarily, if not exclusively, from the accident or claims record of the insured. Thus, clean risks are equated with good risks. The fault of this reasoning lies in the assumption that clean risks are the same as low probability risks and that insurance is a system which allocates cost retrospectively rather than prospectively. In other words, the purpose of insurance is not to pay for what actually happened but to pay for what might have happened.[51]

To the extent manufacturers and businesses believe they will be able to obtain competitive, i.e., lower, insurance rates from risk retention groups they are being misled into a false notion of competitive insurance rates. A good claim record on the part of a particular manufacturer or business does not necessarily indicate that the risk of loss associated with manufacturing or business operations is low, particularly in cases where the number of liability exposures is small or the time period of potential liability is long. Consequently, proponents of the PLRRA who urge manufacturers and businesses to support the Act on grounds that it will reduce their insurance costs are misrepresenting the capabilities of the PLRRA to reduce insurance rates.

Finally, the PLRRA will not inject an element of competition on the product liability insurance market, even if that market were not competitive, because risk retention groups have little flexibility to compete with "commercial insurers" for lower product liability insurance premiums. The product liability insurance dollar of "commercial insurers" is comprised of three basic elements: a pure loss element (approximately 57% of the premium dollar); an expense element (approximately 38% of the premium dollar); and a profit element (approximately 5% of the premium dollar).[52] Because the PLRRA requires risk retention groups to establish reserves based on "sound actuarial principles"[53] it will be very difficult for a risk retention group to establish rates based on lower pure loss estimates than "commercial insurers." Nor will risk retention groups be able to effectively compete with "commercial insurers" for lower levels of the expense and profit elements of the product liability premium dollar . Like "commercial insurers", product liability risk retention groups must calculate rates, pay claims, perform general administrative functions and pay state taxes.[54] Unlike "commercial insurers", however, risk retention groups must hire outside insurance experts,[55] comply with federal antitrust laws[56] and bear the cost of their own regulation.[57] These additional requirements will certainly add costs to the overall operations of risk retention groups and greatly reduce, if not eliminate, any cost saving features contemplated in the risk retention concept. The Department of Commerce implicitly acknowledged these additional costs when it noted "[a] pproved groups will be subject to more stringent requirements [than commercial insurers] in several cases."[58] In sum, the practicalities of operating a risk distribution mechanism which must establish rates based on "sound acturial principles", pay for its own regulation, hire outside insurance experts, comply with federal antitrust laws and pay state premium, income and property taxes dictate that a product liability risk retention group will have little flexibility to offer lower product liability insurance rates to its members than rates currently available in the private market.

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[49] See *Hearings on the Product Liability Risk Retention Act Before the Senate Comm. on Commerce, Science and Transportation*, 96th Cong., 2d Sess. — (1980) (Statement of Mr. Dennis R. Connolly of the American Insurance Association).

[50] The insurance rating laws of Colorado, Minnesota, Nevada, New York, Oregon, Utah, Virginia and Wisconsin authorize the commissioner of insurance to "reimpose prior approval filing requirements if competition does not seem to be working." HANSON, DINEEN & JOHNSON, MONITERING COMPETITION: A MEANS OF REGULATING THE PROPERTY AND LIABILITY INSURANCE BUSINESS 407-08 (1973).

[51] *Hearings on the Rights and Remedies of Insurance Policyholders Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Judiciary Comm.*, 95th Cong., 2d Sess. 104, 108 (1978) (Statement of Commissioner Harold R. Wilde, Jr. on Behalf of the NAIC).

[52] See H.R. REP. NO. 95-997, *supra* note 3, at 18.

[53] PLRRA § 104(a).

E. THE PLRRA IS NOT NEEDED TO PREVENT THE OUTFLOW OF CAPITAL TO OFFSHORE JURISDICTIONS

A fifth objective of the PLRRA, according to the Commerce Department, is to "[r] educe the outflow of capital and premiums to off-shore jurisdictions which have been attracting captive insurance companies."[59] While it is true that the PLRRA provides manufacturers and businesses with an alternative to offshore captives, state insurance laws presently operate to provide a similar alternative to manufacturers and businesses. Colorado,[60] Tennessee[61] and Virginia[62] have enacted special legislation to permit the incorporation of captive insurance companies in their states. A significant number of manufacturers and businesses have taken advantage of the opportunity to establish captive insurance companies under the Colorado law.[63] Because the Tennessee and Virginia laws are relatively new it is too early to estimate the number of captive insurance companies that will be formed under those provisions. In any event, manufacturers and businesses desiring to form captive insurance companies can do so under existing state laws. One of the principal purposes of such laws is to reduce the outflow of capital and premiums to offshore jurisdictions; there is little need to enact a federal law which is intended to accomplish the same purpose.

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[54] See PLRRA § 106(b).

[55] The Commerce Department itself acknowledges that "[i] n most instances, the groups will be managed by insurance brokers or insurance companies." DOC RESPONSE, supra note 13, at 14 n.17.

[56] PLRRA § 107.

[57] PLRRA § 111(a).

[58] BACKGROUND PAPER, supra note 4, at 7.

[59] Id. at 2.

[60] COLO. REV. STAT. §§ 10-6-101 to 10-6-130 (1976).

[61] TENN. CODE ANN. §§ 55-4501 to 55-4529 (Supp. 1978).

[62] Ch. 665, 1980 Va. Acts — (Approved April 4, 1980).

[63] The Colorado Insurance Department has licensed 29 captive insurance companies since the Colorado captive insurance company law was enacted in 1972. Hearings on the Product Liability Risk Retention Act of 1979 Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce, 96th Cong., 1st Sess. — (1979) (Statement of Colorado Insurance Commissioner J. Richard Barnes).

III. TITLE II OF THE PLRRA AND THE SALE OF PRODUCT LIABILITY INSURANCE ON A GROUP BASIS

The Commerce Department has maintained that "regulatory obstacles to the group purchase of insurance [exist] in more than 45 states."[64] To alleviate these alleged obstacles the Commerce Department has drafted Title II of the PLRRA. That title preempts state laws which prohibit insurers from providing product liability or completed operations liability insurance on a group basis to "Title II groups" or members thereof.[65] A "Title II group" is defined as "any group which has as one of its purposes the purchase of product liability or completed operations liability insurance on a group basis."[66] We do not believe Title II of the PLRRA is needed to allow product liability insurance to be marketed on a group basis because state laws are no real obstacle to the sale of group product liability insurance today.

The foundation of the Commerce Department "finding" that 45 states have established regulatory obstacles to the sale of group product liability insurance is the statutes, regulations and department rulings involving so-called "fictitious groups." State fictitious group laws and rulings were established primarily in the decade of the 50's "to discourage mass marketing of automobile insurance."[67] Agents' opposition to the practice of insuring "fictitious fleets" of automobiles led to the promulgation of statutes, regulations and insurance department rulings by the states inhibiting the mass marketing of all types of property/casualty insurance coverage.[68] The primary rationale for such restrictions was that the lower rates associated with group insurance violated state rating law proscriptions against "unfair discrimination."[69] Commentators who have examined this rationale for fictitious group prohibitions have been very critical of its merits:

> One of the classic objections to group property and liability insurance and other forms of mass marketing is that it will result in discrimination either in favor of group participants and against those outside the group, or else among the group members. This objection is a myth when it is considered in the light of the experience under group life and health insurance plans. There, the objection is no longer taken seriously. Despite express prohibition of discrimination in the Model Unfair Trade Practices Act, which has been adopted in form or substance in all state, [sic] the discrimination argument is no longer given credence on the group life and health side. The discrimination argument should be given no more weight in arguments over mass-marketed property and liability insurance.[70]

The legitimacy of the discrimination rationale for fictitious group laws and rulings would therefore seem questionable.

The NAIC reviewed the merits of mass marketed property and casualty insurance in the early 1970's. The staff of the NAIC prepared an extensive analysis of mass marketed property and casualty insurance in August 1971.[71] As a result of its review of the problems of mass marketed property and casualty insurance, the NAIC adopted the following position on mass marketing on November 30, 1971:

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[64] DOC RESPONSE, supra note 13, at 7.

[65] PLRRA § 202.

[66] PLRRA § 3(13).

[67] HANSON & DINEEN, THE REGULATION OF MASS MARKETING IN PROPERTY AND LIABILITY INSURANCE 98 (1971).

[68] Id.

[69] Id. at 99; KIMBALL & DENENBERG, MASS MARKETING OF PROPERTY AND LIABILITY INSURANCE 97 (1970).

[70] KIMBALL & DENENBERG, supra note 69, at 61 (footnote omitted).

[71] See generally HANSON & DINEEN, supra note 67.

1. Mass marketing is neither unfairly discriminatory per se nor so inherently conducive to unfair discrimination as to warrant its blanket prohibition.

2. Under established principles of law, unless there is specific statutory language to the contrary, no special legislation is required to permit any insurer to utilize any of the existing methods of marketing, including mass marketing. The authority to engage in the insurance business conferred by statute enables each insurer to select the method or methods of marketing which it believes appropriate without special enabling legislation.

3. For those states having rating laws which have been construed to unduly restrict the freedom of insurers to engage in mass marketing the Subcommittee recommends for the consideration of such states the adoption of a clarifying statute.

4. The Subcommittee recommends that fictitious group laws be repealed in those states where they have proved to be unduly restrictive.

5. The Subcommittee expresses its disapproval of so-called guideline legislation, which in the guide of sanctioning mass merchandising, actually imposes onerous restrictions which are intended to throttle the operation of mass merchandising.

6. The Subcommittee believes that the NAIC should adopt a model regulation which clearly authorizes the writing of a broad range of mass marketed programs but, at the same time, imposes regulatory safeguards focusing on the unique attributes of mass marketing.[72]

The NAIC has specifically recommended, therefore, that restrictive fictitious group laws be repealed and that properly regulated property/casualty insurance coverages be permitted to be sold on a group basis.

The Commerce Department statement that "regulatory obstacles to the group purchase of insurance" exist in 45 states is difficult to understand, particularly with respect to product liability insurance. Our research indicates that 22 states[73] have statutes and another 14 states[74] have regulations which can be interpreted to apply to "fictitious groups." Many of the 22 statutes cannot be labeled "obstacles" to the sale of group product liability insurance, however, since some statutes apply only to personal lines coverages,[75] while others are clearly permissive in nature.[76] Likewise, some of the 14 regulations cannot be labeled "obstacles" because they either are permissive in nature[77] or have been superceded by subsequent regulations[78] or statutes[79] which themselves are permissive in nature. The conclusion of the Department of Commerce that 45 states pose obstacles to the sale of group product liability insurance is therefore overstated.

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[72] I NAIC PROCEEDINGS 58 (1972).

[73] ALASKA STAT. ANN. § 21.36.190 (1966); ARK. STAT. ANN. § 66-3024 (1966); CONN. GEN. STAT. ANN. § 38-93a (West 1969); DEL. CODE ANN. tit. 18, § 2304 (19) (1975); FLA. STAT. § 626.973 (1972); GA. CODE ANN. § 56-712(4) (1979); HAWAII REV. STAT. § 431-754 (Supp. 1979); IDAHO CODE § 41-1317 (1979); KY. REV. STAT. ANN. tit. 22, § 731 (Baldwin 1971); ME. REV. STAT. ANN. tit. 24A § 2931 (West Supp. 1979); MD. ANN. CODE art. 48A, § 231 (Supp. 1979); MASS. GEN. LAWS ANN. ch. 175, § 193R (West 1979); MISS. CODE ANN. § 83-5-27 (1978); MONT. REV. CODES ANN. § 33-18-207 (1961); N.H. REV. STAT. ANN. § 407-B:2(III) (1979); N.C. GEN. STATS. § 58-30.2 (1979); OKLA. STAT. ANN. tit. 36 § 6001 (West 1978); ORE. REV. STAT. § 737.346 (1979); S.C. CODE ANN. § 38-37-340 (Supp. 1979); TENN. CODE ANN. § 56-1226 (1978); UTAH CODE ANN. § 31-27-22 (1974); WYO. STAT. § 26-13-122 (1967).

[74] Ala. Dept. Reg. No. 16 (Aug. 1, 1957); Colo. Bull. No. 32 (Sept. 1, 1958); Ill. Rule 9-06 (Mar. 1, 1959); Iowa Bull. No. B-4 (Nov. 1, 1958); Mo. Dept. Order No. 71 (Nov. 21, 1958); Neb. Rule 18 (May 1, 1973); Nev. Dept. Ruling No. 57-6 (Sept. 20, 1957); N.Y. Reg. No. 58 (Nov. 25, 1970); Ohio Gen. Bull. No. 27 (April 9, 1958); 31 Pa. Code § 113.55 (Dec. 18, 1971); R.I. Reg. of Feb. 1, 1958; Wash. Bull. of March 12, 1962; W. Va. Admin. Reg. X § 5:02 (May 15, 1972); Wis. Admin. Code § Ins. 6.08 (July 1, 1960).

Even where it is relatively clear that a fictitious group statute or regulation is prohibitive in nature, the manner in which such statute or regulation is interpreted is more important than the language of the statute or regulation itself. Commentators who have studied mass marketing restrictions have observed that:

> the attitude of the administrative officials is more important than the existence of specific statutes or regulations in determining the regulatory climate for collective merchandising.[80]

The attitude of individual insurance commissioners toward mass marketed property and casualty insurance has proven more favorable than the Commerce Department supposes. Commentators who have reviewed the interpretation of "unfair discrimination" language in fictitious group statutes and regulations have concluded that such language is "often interpreted out of the picture."[81] The actual implementation of fictitious group laws and regulations is illustrated here not to suggest that insurance commissioners fail to enforce state insurance laws, but to highlight the fact that legitimate mass marketed insurance products can be made available to the public under existing state laws. Product liability coverages sold to bona fide industry trade associations on a group basis would appear to fall within this category of mass marketed insurance.

Despite differences of opinion on the impact of state laws on the marketing of group product liability insurance coverages, the NAIC and the Department of Commerce share common objectives. Both of us believe that manufacturers and businesses should be given an opportunity to purchase properly supervised group insurance coverages. To the extent state laws and regulations stand as barriers to this objective, they should be modified to permit the sale of legitimate mass marketed products to manufacturers and businesses. The proper solution to inappropriate state laws and regulations, in our opinion, is to amend or repeal such provisions at the state level and not mandate their elimination through federal preemption.

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[75] *See, e.g.*, HAWAII REV. STAT. § 431-754 (Supp. 1979) (auto only); MASS. GEN. LAWS ANN. ch. 175, § 193R (West 1979) (auto and homeowners); S.C. CODE ANN. § 38-37-340 (Supp. 1979) (auto only).

[76] Statutes are considered "permissive" if they only prohibit fictitious groups which are not approved by the insurance commissioner or which are formed principally for the purpose of obtaining insurance. *See, e.g.*, ME. REV. STAT. ANN. tit. 24A § 2931 (West Supp. 1979); GA. CODE ANN. § 56-712(4)(b) (1979); MD. ANN. CODE art. 48A, § 231(b) (Supp. 1979). *See also* WIS. STAT. § 625.11(4) (1977).

[77] *See, e.g.*, Neb. Rule 18 (May 1, 1973); 31 Pa. Code § 113-55 (Dec. 18, 1971); W. Va. Admin. Reg. X § 5:02 (May 15, 1972).

[78] *Compare* N.Y. Dept. Ruling of Dec. 4, 1958, *with* N.Y. Reg. No. 58 (Nov. 25, 1970); *compare* Fla. Bull. No. 211 (Aug. 5, 1957), *with* Fla. Fire & Cas. Bull. No. 74-9 (July 12, 1974).

[79] *Compare* Wis. Admin. Code § Ins. 6.08 (July 1, 1960), *with* WIS. STAT. § 625-11(4) (1977).

[80] WEBB, MASS (COLLECTIVE) MERCHANDISING OF AUTOMOBILE INSURANCE 160 (1969) (Report to the Subcommittee on Antitrust of the Senate Judiciary Committee).

[81] KIMBALL & DENENBERG, *supra* note 69, at 101. *See also* HANSON & DINEEN, *supra* note 67, at 100, 104.

IV. NAIC REPLY TO COMMERCE DEPARTMENT ANALYSIS

On November 30, 1979 the NAIC submitted a written statement to the House Subcommittee on Consumer Protection and Finance listing reasons why the NAIC opposes the PLRRA. Two months after this submission the Commerce Department Task Force on Product Liability and Accident Compensation provided to the chairman and ranking minority member of that Subcommittee, pursuant to their request, a memorandum responding to the November 30 statement of the NAIC.[82] This response contained a point-by-point discussion of the objections raised by the NAIC against the PLRRA. The NAIC would now like to directly reply to some of the major points in the Commerce Department memorandum. Although time does not permit an extensive point-by-point examination of the Commerce Department memo, a few major errors and deficiencies will suffice to illustrate the Commerce Department's shallow understanding of insurance and the insurance regulatory process.

A. PURPOSE OF STATE INSURANCE LAWS

In its analysis of the regulatory burdens facing a hypothetical risk retention group, the Commerce Department observes that:

> The overriding objective of the state insurance regulatory system is to ensure the solvency of all commercial insurers. . . . The impact of the state regulatory requirements upon commercial insurers in terms of time, cost, and other burdens is substantial. While these requirements may be justified for commercial insurers, they are not for risk retention groups.[83]

The notion that state insurance laws were enacted to govern "commercial" insurers is ridiculous. In the first place, the term "commercial" is not defined by the Commerce Department. If a "commercial" insurer is one which conducts the business of insurance for a "profit", there are numerous examples of nonprofit organizations which are subject to state insurance laws.[84] Either the Department of Commerce is uninformed about the scope of state insurance regulation or the term "commercial" has a different meaning than conducting the business of insurance for a profit. If the Commerce Department defines the term "commercial insurer" as one which solicits business from the public at large, there are numerous types of insurers subject to state insurance regulation which limit their insurance activities to defined catagories of persons. Reciprocals, captive insurers, fraternal benefit societies and closed panel prepaid legal plans are a few examples of these types of insurance entities. Certainly the Department of Commerce did not intend to define the word "commercial" in terms of public solicitation and ignore the variety of nonpublic insurance entities subject to state insurance laws. We must admit we do not know what the Department of Commerce means when it says that state insurance laws regulate "commercial" insurers.

Regardless of the meaning of the term "commercial" insurer, the goals of state insurance regulation are twofold: to ensure the reliability of the insurance product and encourage fairness, equity and reasonableness in the relationship between insurer and insured.[85] These goals transcend the particular business form assumed by the insurance entity and apply to anyone transacting the "business of insurance." The purpose of any insurance regulatory law applicable to product liability risk retention groups – either federal or state – is no different than the purpose of existing state laws governing all types of insurance entities. Since there is no question that risk retention groups are transacting the "business of insurance" within the meaning of the McCarran Act, there is no legitimacy to the claim that they deserve different regulatory treatment than other insurance entities. To argue that risk retention groups are not a proper subject of state insurance regulation because the purpose of such regulation does not fit the "unique" operations of risk retention groups is to reveal a surprising lack of understanding of the insurance regulatory process.

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[82] See generally DOC RESPONSE, supra note 13.

[83] Id. at Attachment A.

[84] Hospital and medical service corporations, or Blue Cross and Blue Shield plans, are perhaps the most well-known nonprofit insurance institutions subject to state insurance regulation. Fraternal benefit societies, health maintenance organizations and prepaid legal service plans are lesser known nonprofit entities which are regulated under state insurance laws. Even mutual insurance companies can be included in the class of "nonprofit" insurance entities since, technically speaking, a mutual insurance company does not earn "profits".

[85] E.g., S. Kimball, An Approach to a General Theory of Insurance Regulation, in INSURANCE, GOVERNMENT AND SOCIAL POLICY 5-9 (S. Kimball & H. Denenberg eds., 1969); J. Hanson, An Overview – State Insurance Regulation, 31 CLU JOURNAL 20, 23 (April 1977); W. Huff, Development of Public Policy from the Viewpoint of a State Insurance Regulator, Insurance Law Journal 393, 394 (July 1975).

B. IMPACT OF THE PLRRA ON THE MC CARRAN ACT

Since the Department of Commerce fails to grasp the purposes of state insurance regulation, it is not surprising that the Department minimizes the impact of the PLRRA on state insurance regulation under the McCarran Act. The NAIC asserted in its November 30, 1979 statement to the House Subcommittee on Consumer Protection and Finance that the PLRRA represents "a substantial change in the policies underlying the McCarran Act."[86] The Commerce Department's response to this NAIC concern was: "[t]o the contrary, the Risk Retention Act does not amend the McCarran-Ferguson Act . . . . Commercial insurers will continue to be regulated by the states and not the Federal Government."[87] In typical fashion the Commerce Department dismissed a concern of the NAIC with an irrelevant observation that the PLRRA does not amend the McCarran Act. We never stated or implied that the PLRRA amends the McCarran Act; we instead expressed our concerns that the Congress would exempt product liability risk retention groups from state insurance regulation and thereby deviate from the declared policy of the McCarran Act that "the continued regulation and taxation by the several States of the business of insurance is in the public interest. . . . "[88]

C. PRECEDENT FOR FEDERAL PREEMPTION

Section 106 of Title I of the PLRRA broadly preempts any state law that regulates directly or indirectly a risk retention group. In its early analysis of the PLRRA the Department of Commerce stated that "[t]here is precedent at both the federal and state levels for exempting group risk retention mechanisms from state insurance regulation."[89] The Department went on to cite the Employee Retirement Income Security Act (ERISA)[90] and the federal Health Maintenance Organization Act[91] as examples of federal laws which preempt state regulation of risk retention mechanisms. Unfortunately, the Commerce Department's interpretation of these two federal laws as precedents for preempting state regulation of risk retention mechanisms is legally flawed.

Section 514(a) of ERISA preempts any state law which "relates to" an employee benefit plan.[92] For purposes of ERISA, states are prohibited under section 514(b)(2)(B) from treating employee benefit plans or trusts as insurance companies for purposes of state insurance regulation.[93] But employee benefit plans and trusts are not risk sharing mechanisms similar to product liability risk retention groups. An employee benefit plan is an arrangement between an employer and employees whereby employees are given certain defined benefits in return for their services.[94] A trust is a "right of property, real or personal, held by one party for the benefit of another."[95] The critical insurance elements of risk assumption and risk distribution which characterize a product liability risk retention group are not essential to the definition of either an employee benefit plan or trust. While it is true that an employee benefit plan and trust may be structured in a manner which assumes and distributes risk, it is likewise true that a plan or trust need not assume or distribute risk to be considered an employee benefit plan or trust. Thus, the Commerce Department analogy between product liability risk retention groups and ERISA plans and trusts is false.

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[86] Statement of Lyndon Olson, Jr. on Behalf of the NAIC, *supra* note 28, at —.

[87] DOC RESPONSE, *supra* note 13, at 7.

[88] 15 U.S.C. § 1011 (1970).

[89] BACKGROUND PAPER, *supra* note 4, at 8.

[90] 29 U.S.C.A. § 1144 (1975).

[91] 42 U.S.C.A. § 300e-10 (Supp. 1980).

[92] 29 U.S.C.A. § 1144(a) (1975).

[93] *Id.* § 1144(b)(2)(B).

[94] *See id.* at §§ 1002(1), (2) and (3).

It is interesting that the Commerce Department cited ERISA as a precedent for product liability risk retention groups. Although there is no similarity between a risk retention group and an employee benefit plan or trust, experience with the preemption language of ERISA provides a valuable lesson concerning the wisdom of preempting state insurance laws. Commentators who have reviewed the impact of the preemption language of section 514 of ERISA have agreed that the language of that section has caused innumerable federal-state problems.[96] For example, the NAIC testified before the House Subcommittee on Labor Standards on June 1, 1978 that the preemption language of ERISA spawned the proliferation of uninsured multiple employer trusts (MET's) which "have lead to disasterous results in the welfare benefit field."[97] The NAIC projects that the broad preemption language of section 106 of the PLRRA will generate a plethora of similar problems.

In addition to ERISA, the Commerce Department cites the Health Maintenance Organization Act as precedent for preempting state laws governing risk sharing mechanisms such as product liability risk retention groups. A close reading of the statutory language cited by the Commerce Department in support of its preemption interpretation reveals that the preemption language of that Act is extremely narrow. State laws governing the capital, surplus and reserves of HMO's which are the recipients of federal grants are preempted only to the extent the state laws prohibit HMO's from qualifying for federal grants. Congressman William R. Roy, sponsor of bill which eventually led to the federal HMO Act, recognized the narrowness of the preemption provision of the federal Act when he stated:

> I share the common goals that you have and you apparently are aware of the fact that we worked very hard on this preemption to make it as minimal as possible.
>
> I would like to emphasize that we do not preempt all State insurance regulations by any means and that it is our intention, that (A) 4 preempts only the provisions concerning initial capitalization and establishment of financial reserves that are required for health insurers per se and says requirement [sic] for HMO's should be something less.
>
> . . . .
>
> I think it is a relatively liimted [sic] area we are speaking about, that is, this organization is able to provide services, and has personnel and facilities. In this sense it should not be required to meet the same initial capitalization requirements as a health insurer.[98]

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95. BLACKS LAW DICTIONARY 1680 (4th rev. ed., West 1968).

96. See, e.g., T. Manno, ERISA Preemption and the McCarran Ferguson Act: The Need for Congressional Action, 52 TEMPLE L. Q. 51, 78 (1979); P. Turza & L. Halloway, Preemption of State Laws Under the Employee Retirement Income Security Act of 1974, CATH. U. L. REV. 163, 174-75 (1979); J. Hutchinson & D. Ifshin, Federal Preemption of State Law Under the Employee Retirement Income Security Act of 1974, 46 UNIV. CHI. L. REV. 23, 80 (1978).

97. Hearings on Oversight of ERISA Before the Subcomm. on Labor Standards of the House Comm. on Educ. and Labor, 95th Cong., 2d Sess. 650, 656 (1978) (Statement of the NAIC by Commissioner Herbert W. Anderson).

98. Hearings on H.R. 51 and H.R. 4871 Before the Subcomm. on Public Health and Environment of the House Comm. on Interstate and Foreign Commerce, Ser. No. 93-26, 93d Cong., 1st. Sess. at 250 (1973).

Commentators who have reviewed the legislative history surrounding the federal HMO Act have concurred with Congressman Roy's assessment that the preemption provision of the federal Act is extremely narrow.[99] Thus, reliance by the Commerce Department on the federal HMO Act as precedent for the broad preemption language of section 106 of the FLRRA is misplaced.

D. RISK RETENTION GROUPS AND RECIPROCALS

The NAIC maintained in its November 30 statement to the House Subcommittee on Consumer Protection and Finance that product liability risk retention groups are not a new concept. We observed that a risk retention group is similar in concept to a reciprocal, or interinsurance exchange, "whereby several individuals, partnerships and corporations underwrite each other's risk against loss by fire or other hazard, through an attorney in fact, common to all, under an agreement that each underwriter acts separately and severally, and not jointly with any other."[100] In its response to this observation the Commerce Department stated "[t]here are several very important differences between a risk retention group and a reciprocal."[101] While we confess there are some conceptual differences between a risk retention group and a reciprocal, these differences are not as great as the Commerce Department believes.

The Commerce Department maintains that the several liability of individual subscribers to a reciprocal is conceptually distinguishable from the risk agreement between a risk retention group and its participants. In other words, the fact that a reciprocal may assess its subscribers for additional contributions in the event losses exceed premiums distinguishes a reciprocal from a product liability risk retention group. Although it is true that this assessment feature of a "pure" reciprocal is unlike the risk agreement defined under the PLRRA, state laws have modified this characteristic of a pure reciprocal to permit reciprocals to operate on a nonassessable basis. Most state enabling statutes offer reciprocals the option of either meeting the capital and surplus requirements applicable to stock and/or mutual insurance companies, or issuing insurance policies on an assessable basis.[102] In practice, most reciprocals opt to meet the capital and surplus requirements rather than issue assessable policies. The "important difference" between risk retention groups and reciprocals cited by the Commerce Department is therefore more hypothetical than real.

A second distinction between product liability risk retention groups and reciprocals posed by Commerce Department involves the role of the attorney-in-fact in managing a reciprocal. The Commerce Department properly noted that the operations and management of a reciprocal are conducted through an attorney-in-fact choosen by the subscribers to a reciprocal. The Commerce Department alleges, however, "[t]here is no comparable person or role contemplated for risk retention groups. Such groups will be professionally managed corporations controlled by their shareholders/policyholders."[103] Apparently the Commerce Department chooses to minimize the role played by persons "who shall be responsible for the management of" risk retention groups under the PLRRA.[104] Given the fact that the participants of a product liability risk retention group are manufacturers and businesses which have little or no expertise in the day-to-day operation of an insurance mechanism, it will be extremely unlikely that the participants of a risk retention group will actively manage the affairs of the group. While it is true that the participants of a risk retention group have complete authority to choose and remove the manager of the group, the subscribers of a reciprocal have similar authority to choose and remove their attorney-in-fact. Thus, there is no real difference between the person who is choosen to manage a risk retention group and the attorney- in- fact of a reciprocal.

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[99] D. Brummond, Federal Preemption of State Insurance Regulation Under ERISA, 62 IOWA L. REV. 57, 122 (1976); J. Hanson, The Private Insurance Industry and State Insurance Regulatory Activities as Alternatives to Federally Enacted National Health Insurance Legislation, 6 TOLEDO L. REV. 677, 707 (1975).

[100] Statement of Lyndon Olson, Jr. on Behalf of the NAIC, supra note 28, at —, quoting Robert J. Brennan, Inter-Insurance – Its Legal Aspects and Business Possibilities, 58 CENTRAL LAW JOURNAL 323 (1904).

[101] DOC RESPONSE, supra note 13, at 9.

[102] E.g., CAL. INS. CODE § 1401 (West 1975); COLO. REV. STAT. § 10-13-105 (1976); ILL. REV. STAT. ch. 73, § 687 (1975).

[103] DOC RESPONSE, supra note 13, at 10.

[104] FLRRA § 101(a)(2)(3).

There is a distinction between product liability risk retention groups and reciprocals which was not pointed out by the Commerce Department, however. That distinction is the business form of the risk mechanism. Section 3(10) of the PLRRA provides that a risk retention group may take the form of either a corporation or "other limited liability association taxable as a corporation". A reciprocal, on the other hand, is a separate statutory entity established under state enabling legislation. Since reciprocals have the option of issuing nonassessable policies there is little legal significance to the limited liability distinction between reciprocals and risk retention groups established under the PLRRA. The NAIC continues to maintain that product liability risk retention groups are very similar in concept to reciprocals operating under state insurance laws. The need for new federal legislation so govern this type of risk mechanism is therefore questionable.

E. STATE INSURANCE LAWS AND THE FORMATION OF RISK RETENTION GROUPS

The Department of Commerce has consistently maintained that "[s] tate insurance laws contain barriers to the formation of risk retention groups which are inappropriate and which, as a practical matter, preclude their formation."[105] The Commerce Department has spent a great deal of time and effort attempting to prove that it is "impossible" to form risk retention groups under state insurance laws. Two extensive hypothetical strategies were prepared by the Commerce Department to illustrate the regulatory "burden" of operating a hypothetical risk retention group on a multi-state basis.[106] Not only do we disagree that state laws governing the solvency of risk mechanisms are "inappropriate", but we seriously question the "impossibility" of establishing and operating a product liability risk mechanism on a multi-state basis.

The NAIC does not feel that state laws establishing requirements for the financial solidity of insurance mechanisms such as risk retention groups are "inapporpriate". State requirements outlined in the Department of Commerce discussion of hypothetical risk retention group are intended to protect policyholders and claimants against the possibility that insurance claims will go unpaid. These requirements are no less appropriate for ensuring the financial solidity of product liability risk retention groups than for other insurance entities currently governed by state insurance laws. While there may be a need to modify some of these requirements to fit the unique circumstances of product liability risk mechanisms,[107] most of the state requirements cited by the Commerce Department are proper regulatory tools for ensuring the financial solidity of product liability risk retention groups.

Even if it is assumed that some of the requirements discussed in the Commerce Department memorandum are "inappropriate" regulatory provisions for product liability risk retention groups, we do not agree that state laws "make it impossible for a risk retention group to be formed."[108] Testimony before this Committee by Mr. Curtis G. Urbanski of the American Insurance Marketing Corporation clearly demonstrates that product liability risk mechanisms can be established and operated within the existing framework of state insurance regulation. Mr. Urbanski testified that "[t] ime and state insurance regulations are not obstacles in the formation of domestic captive insurance companies."[109] Mr. Urbanski specifically described his own work in establishing the WESCAP Insurance Company to insure the product liability risks of individual members of the National Welding Supply Association. The formation of a domestic captive insurance company is not the only option available to manufacturers, businesses and industry trade associations. The NAIC has previously explained that persons wishing to establish product liability risk retention groups under the PLRRA can form reciprocals under state insurance laws to insure their product liability risks.[110] Even if it is conceded that there are multi-state burdens to establishing and operating a product liability reciprocal, most industry trade associations have a sufficient number of members to operate a reciprocal on an intrastate basis.[111] If the Department of Commerce had explored the alternative of an intrastate reciprocal with the same zeal and enthusiasm that it employed in its criticism of state insurance laws we are confident that its conclusion concerning the formation of risk retention groups under state insurance laws would have been different.

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[105] STATEMENT OF PURPOSE AND NEED, supra note 44, at 4.

[106] DOC RESPONSE, supra note 13, at Attachment A.

[107] For instance, mandatory waiting periods for the issuance of a certificate of authority for an insurer to write product liability insurance may place unnecessary restrictions on the ability of insurance entities to begin product liability insurance operations once other state requirements have been met.

[108] DOC RESPONSE, supra note 13, at 16.

[109] Hearings on the Product Liability Risk Retention Act Before the Senate Comm. on Commerce, Science and Transportation, 96th Cong., 2d Sess. — (1980) (Statement of Mr. Curtis G. Urbanski of the American Insurance Marketing Corporation).

F. IMPROPER INTERPRETATIONS OF THE NAIC STATEMENT

In the January 30 memorandum of the Commerce Department theDepartment makes a number of unfair interpretations of the NAIC statement. One such interpretation involves the NAIC belief that "growing legal rights awareness" on the part of the American public is a factor leading to high product liability insurance costs. The Commerce Department responded to this observation by saying "[w]e do not know what steps the NAIC would propose to decrease the awareness of product users of their legal rights and their assertion of those rights."[112] Clearly, the NAIC has never suggested that limiting the rights of product liability claimants would resolve product liability insurance problems. To the contrary, we have carefully avoided predictions that product liability tort reform will lead to lower insurance premiums for manufacturers and businesses. Questions involving substantive rules of recovery for product liability injuries are a matter of public policy to be decided by the state legislatures of the several states. The rationale for action by state legislatures should be basic fairness between product liability litigants, not reductions in insurance costs. We find it anamolus that the Department of Commerce would suggest that the NAIC favors limitations on tort actions when the Department is currently urging the Congress to enact its own uniform product liability law.

A second example of how the Commerce Department twisted our conclusion that growing legal rights awareness has contributed to the product liability problem is the observation that "this assertion is reminiscent of the statements emminating from the insurance industry during the 1974 - 76 period that there were one million product liability claims (or lawsuits) in 1976 and that the number was expected to grow."[113] Associating the NAIC with industry contentions that one million product liability claims were filed in 1976 is grossly unfair. We have consistently maintained that there is insufficient data to determine the precise number of product liability claims being filed annually in the United States. Although some statistics are available which provide insights into trends in product liability claims, these statistics do not provide complete countrywide information. The NAIC has long worked to improve product liability data so that future estimates of product liability claims can be made with greater degrees of precision. We resent the Commerce Department's insinuation that the NAIC accepted the insurance industry's estimate of one million product liability claims in 1976.

V. CONCLUSION

After reviewing the stated objectives of the PLRRA, as pronounced by the Commerce Department, the NAIC finds that the Act falls far short in meeting its objectives. The PLRRA is simply incapable of reducing insurance costs and achieving any of the other affirmative benefits claimed by its proponents. The Department of Commerce has done a skillful job in

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110. Statement of Lyndon Olson, Jr. on Behalf of the NAIC, supra note 28, at —.

111. The National Federation of Independent Businesses, for example, boasts a membership of over 600,000, while the National Association of Wholesaler-Distributors claims an aggregate membership of approximately 43,000 wholesaler-distributors. Certainly these associations are large enough to find 20 members – the minimum number of participants for a risk retention group under the PLRRA – in every state who have the same interest in an intrastate reciprocal as a federally-chartered risk retention group. Even the National Machine Tool Builders Association, which claims a membership of 370 manufacturing companies, will probably have its members concentrated in urban industrial states. The probability of finding 20 members in a single state who desire to form a reciprocal would not appear as remote as proponents of the PLRRA allege. Furthermore, there are no restrictions under state reciprocal enabling acts on the number of subscribers necessary for a reciprocal. The fact that 20 members cannot be found in a single state is therefore not as important as the ability of the potential reciprocal subscribers to amass minimum capital and surplus amounts.

112. DOC RESPONSE, supra note 13, at 3.

113. Id. (footnote omitted).

convincing such diverse groups as manufacturers, businesses, trial lawyers and consumers that the PLRRA will advance their respective interests, however. By failing to recognize major deficiencies in the risk retention concept and giving superficial analysis to complex insurance problems the Commerce Department has been very successful in raising congressional expectations about the potential benefits of the PLRRA. Unfortunately, these expectations prove to be false when subjected to close scrutiny. We hope the Senate Commerce Committee will recognize these false expectations and withhold its approval of the PLRRA.

Because the PLRRA does not provide sufficient protections against the possible insolvency of a risk retention group the Act poses serious dangers to the public interest. The fact that the PLRRA will increase the likelihood that product liability claims will go unpaid, without addressing the fundamental causes of high insurance costs of manufacturers and businesses, makes the Act one of the most anti-consumer insurance proposals considered by the Congress in recent years. We sincerely hope the Senate Commerce Committee will acknowledge this anti-consumer feature of the PLRRA and return the Act to the Department of Commerce. To do otherwise would be a great disservice to the American public.

Senator Stevenson. Thank you, sir. And Mr. Gordon?

Mr. Gordon. Mr. Chairman and members of the Consumer Subcommittee, I am Jerome B. Gordon, special assistant to New Jersey Insurance Commissioner James J. Sheeran. I am currently hearing officer for the department on a pending product liability filing of the insurance services office. Prior to joining the New Jersey Department of Insurance, I was a consultant to Federal and State Government in insurance and public policy matters. In that capacity, I directed the industry study on product liability for the interagency task force on product liability of the U.S. Department of Commerce.

I am here today on Commissioner Sheeran's behalf to express our support for the passage of the Federal Product Liability Risk Retention Act of 1980, S. 1789. It is the belief of the New Jersey Department of Insurance that the Product Liability Risk Retention Act of 1980 is a laudatory measure designed to resolve the difficulties experienced by small businesses throughout the United States in securing adequate product liability insurance protection. Furthermore, the enactment of S. 1789 would benefit consumers by increasing the likelihood of payment for legitimate product injury claims.

While alleviating much of the affordability problems of small- to medium-sized businesses, the Risk Retention Act should also result in an increase in underwriting capital of conventional insurers available for writing excess layer protection. We believe that this is very desirable given the virtual nonavailability of new capital for insurance operations in both personal and commercial lines.

In my statement today, I would like to discuss the precedents for the risk retention concept at both the Federal and State levels, the underlying problems in product liability ratemaking that have been evident in the market crises of the past 5 years for this form of insurance, and finally, I should like to suggest several changes that should materially enhance the Risk Retention Act.

A number of these suggestions arise from our own experience in dealing with related availability/affordability crises in the field of professional liability insurance in New Jersey.

The risk retention concept is not a new one. It's antecedents can be found in the efforts of State and local governments in both Great Britain and the United States to establish self-insurance trust funds and self-owned mutual companies for the handling of municipal liability risks. In the United States today, more than 19 States have enabling legislation permitting the establishment of such forms of municipal risk retention for property and liability insurance. The States of Florida and South Carolina passed statutes in the midseventies that permit the establishment of risk retention groups and group self-insurance programs for workers' compensation and employer liability insurance.

At the Federal level, we have existing authority for the formation of self-administered risk retention groups for hospital and professional liability under medicare. Moreover, these hospital liability risk retention groups have the authority to establish self-insurance trust funds on an actuarial basis for the handling of these risks.

In a related fashion, many States in the wake of the medical malpractice and related hospital liability insurance crises in the midseventies, passed enabling legislation to create so-called "bedpan" mutuals. New Jersey passed legislation that permitted the formation of a Joint Underwriting Association for the handling of both excess and primary layer protection for physicians, surgeons, and hospital mutuals.

As an indication of the efficacy of this approach, the New Jersey Medical Malpractice Reinsurance Association has returned nearly 50 percent of the premiums collected from the respective mutuals in each of the two latest operating periods. These precedents clearly indicate that the risk retention concept is neither a new one nor one unfamiliar to the insurance industry and State regulators.

The formal establishment of risk retention groups analogous to the proposed product liability concept can also be traced to several Internal Revenue Service tax rulings in the ocean and marine surety insurance field during the 1950's. The Internal Revenue Service granted favorable revenue rulings for the complete tax deduction of joint contributions of ocean and marine coastal carriers for the establishment and financing of what were, in effect, risk retention groups. These risk retention groups were used as a vehicle to fund a deductible for business insurance. The IRS required these pioneering risk retention groups to secure the approval of the State insurance regulators.

Risk retention groups should not be subject to the same operating capital and surplus requirements as are most admitted carriers or reciprocal exchanges. This is because the purpose of the risk retention group is to fund jointly the deductible or first layer of insurance protection, while purchasing or making arrangements for the excess layer. Therefore, to apply the capital and operating surplus requirements of a full-line insurance entity would not make good sense.

The experience with the precedents for the product liability risk retention concept have indicated that they offer an effective shield against panic pricing in the conventional insurance markets. Further, they offer significant incentives for group members through economies of scale in purchasing coverages, administering loss adjustment and claims handling activities. Because of stop loss limitations and the size of these risk retention groups, there would be few problems, when properly administred, with meeting accident victims' compensation losses.

The creation of insurance exchanges in the States of New York, Illinois, and Florida should aid in the functioning of prospective risk retention groups. The New York Insurance Exchange opened for activities on March 31 of this year. The Illinois Exchange will open for business in June of this year, while the Florida Exchange may be in operation in early 1981.

These exchanges would provide an auction market for the placement of umbrella coverages for domestic insurance entities on an efficient basis. The placement of umbrella coverages or excess layer protection could be efficiently coordinated with more conventional forms of reinsurance.

It is noteworthy that one of the early syndicates formed on the New York Insurance Exchange will handle placements for a number of trade association insurance captives. In like form, approved risk retention groups under the provisions of the Federal act could very likely avail themselves of these arrangements.

Let me now address some of the underlying problems of conventional product liability insurance. The New Jersey Department of Insurance has recently conducted a rather extensive hearing on a product liability rate filing made nationwide by the Insurance Services Office. The ISO is the major filing advisory organization for the principal product liability insurers throughout the United States.

Our examination of and public hearings on this filing have revealed several facets about the pricing of product liability insurance that bear close examination for their implications both for the operation of the conventional market and alternative mechanisms.

First, the loss data that are used for general rate level determinations in product liability are relatively stale and do not reflect the bottoming out of loss trends in this general liability subline in recent years.

Second, there is inconsistent treatment of underlying manual and (a) rate loss data in the derivation of suggested rate indications, particularly at the increased limits.

Third, there is a complete departure from the prevailing practices of adjusting losses for trend in general liability ratemaking for this subline that substantially increases both basic and increased limits rate indications.

Fourth, cash flow analysis of product liability insurance premiums and loss payout patterns show that rates of return on equity are high. We feel that insufficient recognition of the substantial return from investment income in establishing general rate levels for such long-tail lines as product liability leads to overpricing.

Fifth, disclosure should be made to products manufacturers and sellers at time of application and renewal that would clearly explain what classifications they are assigned to, the manual or (a) rate used to derive premiums, and any resulting deviation therefrom.

Based on these deficiencies in product liability ratemaking, there are few prospects for individual insureds who are product manufacturers and sellers to obtain significant economies of scale in the purchase of conventional coverages. The Product Liability Risk Retention Act would enable approved groups to contain resulting insurance costs. However, upon review of the current proposed legislation, the New Jersey department contends that there is room for improvement.

While the New Jersey Department of Insurance supports the Federal Product Liability Risk Retention Act, we nevertheless offer a number of suggestions that should enhance the ultimate regulation and operation of approved groups.

First, we suggest that the question of solvency of risk retention groups can be resolved by making these groups members of either Federal or State Property Liability Insurance Guaranty Funds. If this course of action were followed, then at the State level, approved risk retention groups would be subject to applicable premium taxes, surcharges, and assessments for solvency.

Second, the present version of the act relies on the protection of the Federal Bankruptcy Act for the handling of possible failures of approved risk retention groups. This is sufficient if provision is made for making groups members of guaranty funds. If this is not done, we suggest the inclusion of an additional section or title in this act that would establish formal rehabilitation and liquidation procedures and grant authority to the Secretary of Commerce to implement them. These rehabilitation and liquidation procedures could follow existing State insurance statutes as to form and content in order to insure adequate protection for accident victims and group members.

Third, we suggest that this committee might consider the adoption of an innovation that we have fashioned in New Jersey for handling of professional malpractice insurance affordability/availability problems. We have found in our experience that the New Jersey Medical Malpractice Reinsurance Association created by statute for this insurance line has weathered successfully all spot availability problems and has resulted in substantial reduction of liability insurance costs for both medical professionals and health care facilities.

I have previously cited the rather significant return of premiums in the last two operating periods of the Reinsurance Association. Therefore, we suggest that the Senate might consider the granting of standby authority to the Secretary of Commerce for a comparable entity in the field of product liability insurance.

This entity would amount to a direct writer of excess layer protection using a single-tier market rate for such protection. The Secretary of Commerce could activate the creation of this standby market availability syndicate through administrative hearing and determination.

The Secretary could, after public hearing and comment, recommend to the President creation of the syndicate. It would be appropriate in an additional title of the Product Liability Risk Retention Act to spell out the enabling authorities, powers, reporting requirements, and certification of losses for both the suggested Product Liability Market Availability Syndicate and related oversight responsibilities of the Secretary of Commerce.

In closing, Congress has the opportunity to devise insurance arrangements to facilitate efficient securing of product liability insurance arrangements while ensuring the compensation of product accident victim losses. It is the contention of the New Jersey Department of Insurance that the Product Liability Risk Retention Act will achieve this goal.

We would like to thank you for the opportunity of presenting our positions and views on this significant solution to the continuing problem of affordability/availability of insurance for the Nation's product manufacturers and sellers.

Thank you.

Senator STEVENSON. Thank you, sir. We are grateful to all of these witnesses.

The record will remain open for questions and additional comments for 10 days.

We are adjourned.

[Whereupon, at 1 p.m., the hearing was adjourned.]

PRODUCT LIABILITY RISK RETENTION ACT OF 1979

WEDNESDAY, JULY 30, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, D.C.

The committee met at 10:12 a.m., in room 235, Russell Senate Office Building, Hon. Howard W. Cannon (chairman of the committee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The hearing will come to order.

Good morning, ladies and gentlemen. Today we continue our hearings on S. 1789, the Product Liability Risk Retention Act.

This morning we will focus on the staff working draft. We have invited the views of business and insurance groups on this bill and its acceptability as an alternative to the House-passed measure. Written comments on the staff working draft were received from more than 40 organizations. Over 40 business groups endorsed the proposal.

Some insurance industry groups indicated support for the bill or support for the concept, while others continued to voice strong reservations about any Federal legislation in this area.

We are holding this hearing this morning so that the committee can have an opportunity to hear directly the views of those who have expressed a strong interest in this legislation and requested to testify.

Let me briefly review the prior history on the bill. The committee held a hearing on April 22 of this year on S. 1789 and the similar House-passed bill, H.R. 6152. At that time, considerable opposition was expressed regarding the creation of a new Federal regulatory agency to charter risk retention groups.

In addition, a number of technical questions regarding the operation of the commercial insurance business were left unanswered.

In order to obtain more background information and resolve some of these questions, Senator Packwood and I requested that the Department of Commerce convene a forum to explore these issues. A meeting was held at the Department of Commerce on May 21, and a number of experts who both favored and opposed this legislation discussed current regulation of captive insurance companies and current regulation of mass marketing of insurance.

The staff working draft was based on the prior hearing, the meeting at the Department of Commerce, and additional research. I want to point out that, in spite of the strong backing of manufacturing groups for the Risk Retention Act, this committee has not moved precipitously on this legislation.

We have tried to listen to the testimony of the critics and to address their concerns, and we will continue that today. But I think I must add that, given the sharp differences between the point of view of manufacturers and some of those in the insurance industry, it is very difficult to completely reconcile the competing views.

As I said in a speech to the Insurance Information Institute last month, I am very sympathetic to the concerns expressed by manufacturers that the cost of product liability insurance poses a real problem.

However, I am also sympathetic to the views expressed by the insurance industry that it would be unwise to establish a new Federal regulatory system. We will not create any new regulatory bureaucracy if it is not needed; but we will take action if it is necessary to assure manufacturers and sellers of products that they have reasonable options available to them for obtaining product liability insurance coverage.

That is the basic approach that I have toward this legislation, and before we hear the views of our witnesses this morning I would like to place in the record a letter which the committee has received from the Department of Commerce which supports the staff working draft. Let me quote from the Department's letter:

> We are pleased to state that this Department fully supports the approach your staff has taken with respect to the formation of risk retention groups. We will work with you to ensure the enactment of a Risk Retention Act in this session of Congress. The Congress and the Administration will then have taken a major step toward addressing the continuing and serious difficulties that have adversely affected American business in the product liability insurance market.

The letter also says: "We commend your staff for developing a proposal that should accomplish these goals without creating a new Federal chartering mechanism."

We are very pleased to receive this letter from the Department of Commerce, and it will be placed in the record.

[The material referred to follows:]

[STAFF WORKING DRAFT]

JULY 24, 1980

96TH CONGRESS
2D SESSION
S.

To facilitate the ability of product sellers to establish product liability risk retention groups, to purchase product liability insurance on a group basis, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JULY , 1980

Mr. introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

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A BILL

To facilitate the ability of product sellers to establish product liability risk retention groups, to purchase product liability insurance on a group basis, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Product Liability Risk Retention Act of 1980".

DEFINITIONS

SEC. 2. (a) As used in this Act:

(1) "completed operations liability" means liability arising out of the installation, maintenance, or repair of any product at a site which is not owned or controlled by—

(A) any person who performs that work; or

(B) any person who hires an independent contractor to perform that work;

but shall include liability only for activities which are completed or abandoned before the date of the occurrence giving rise to the liability;

(2) "insurance" means primary insurance, excess insurance, reinsurance, surplus lines insurance, and any other arrangement for shifting and distributing risk which is determined to be insurance under applicable State or Federal law;

(3) "product liability" means liability for damages because of any personal injury, death, emotional harm, consequential economic damage, or property damage (including damages resulting from the loss of use of property) arising out of the manufacture, design, importation, distribution, packaging, labeling, lease, or sale of a product, but does not include the liability of any person for those damages if the product involved was in the possession of such a person when the incident giving rise to the claim occurred;

(4) "risk retention group" means any corporation or other limited liability association taxable as a corporation, or as an insurance company, formed under the laws of any State or foreign nation—

(A) whose principal activity consists of assuming and spreading all, or any portion, of the product liability or completed operations liability risk exposure of its group members;

(B) which is organized for the primary purpose of conducting the activity described under subparagraph (A);

(C) which is chartered as an insurance company under the laws of any State or foreign nation; and

(D) which does not exclude any person from membership in the group solely to provide for members of such a group a competitive advantage over such a person;

(5) "purchasing group" means any group of persons which has as one of its purposes the purchase of product liability or completed operations insurance on a group basis; and

(6) "State" means any State of the United States or the District of Columbia.

(b) The definition of "product liability" in paragraph (4) of subsection (a) of this section shall not be construed to affect the tort law of any State.

RISK RETENTION GROUPS

SEC. 3. (a) Except as provided in this section, any person specified in subsection (b) is exempt from any State law, rule, regulation, or order to the extent that such law, rule, regulation, or order would—

(1) make unlawful, or regulate, directly or indirectly, the operation of a risk retention group other than under the laws of the jurisdiction in which it is chartered, except that a State may require such a group to—

(A) comply with the unfair claim settlement practices law of the State; and

(B) pay, on a nondiscriminatory basis, applicable premium and other taxes which are levied on admitted insurers and surplus lines insurers, brokers, or policyholders under the laws of the State;

(2) require a risk retention group to participate in any insurance insolvency guaranty fund, other than in proportion to the ratio of its premiums derived from risks in the State to the total premiums written by all insurers in the fund;

(3) require a risk retention group to participate in a board, bureau, or residual market mechanism authorized by or established under State law;

(4) require any insurance policy issued to a risk retention group or any member of the group to be countersigned by an insurance agent or broker residing in that State; or

(5) otherwise discriminate against a risk retention group or any of its members.

(b) The exemptions specified under subsection (a) shall be applicable to—

(1) any risk retention group;

(2) any person who is a member of a risk retention group; and

(3) any person who provides; (A) product liability, completed operations or comprehensive general liability insurance; (B) insurance-related services; or (C) management services to any group or person described in paragraph (1) or (2).

PURCHASING GROUPS

SEC. 4. (a) Any person specified in subsection (b) is exempt from any State law, rule, regulation, or order to the extent that such law, rule, regulation, or order would—

(1) prohibit the establishment of a purchasing group;

(2) make it unlawful for an insurer to provide or offer to provide insurance on a basis providing, to a purchasing group or its members, advantages, based on their loss and expense experience, not afforded to other persons with respect to rates, policy forms, coverages, or other matters;

(3) prohibit any person licensed under the laws relating to insurance agents or brokers of any State from acting, or offering to act, as an agent or broker with respect to the provision of such insurance on such a basis to a purchasing group or its members;

(4) prohibit a purchasing group or its members from purchasing insurance on the group basis described in paragraph (2) of this subsection;

(5) prohibit a purchasing group from obtaining insurance on a group basis because the group has not been in existence for a minimum period of time or because any member has not belonged to the group for a minimum period of time;

(6) require that a purchasing group must have a minimum number of members, common ownership or affiliation, or a certain legal form;

(7) require that a certain percentage of a purchasing group must obtain insurance on a group basis;

(8) require that any insurance policy issued to a purchasing group or any members of the group be countersigned by an insurance agent or broker residing in that State; or

(9) otherwise discriminate against a purchasing group or any of its members.

(b) The exemptions specified under subsection (a) shall be applicable to—

(1) any purchasing group;

(2) any person who is a member of a purchasing group; and

(3) any person who provides; (A) product liability, completed operations, or comprehensive general liability insurance; (B) insurance-related services; or (C) management services to any group or person described in paragraph (1) or (2).

APPLICABILITY OF SECURITIES LAWS

SEC. 5. (a) The ownership interests of members in a risk retention group shall not be considered securities for purposes of the Securities Act of 1933 (15 U.S.C. 77a et seq.) or for purposes of the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(b) A risk retention group shall not be considered to be an investment company for purposes of the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.).

(c) The ownership interests of members in a risk retention group shall not be considered securities for purposes of any State blue sky law.

U.S. Department of Commerce,
Washington, D.C.

Hon. Howard W. Cannon,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

Dear Senator Cannon: We now have had the opportunity to review the Committee on Commerce, Science, and Transportation's Staff Working Draft of a proposal intended to facilitate "the ability of product sellers to establish product liability risk retention groups (and) to purchase product liability insurance on a group basis. . . ."

We believe tht this new proposal accomplishes the general purposes of Commerce's original Risk Retention Act of 1980. First, it will help assure that product liability rates and premiums are set on a competitive basis. Second, it will provide additional capacity in the product liability insurance market. This is especially important in light of the widely anticipated downswing that is expected in the property/casualty market in 1981.

We commend your staff for developing a proposal that should accomplish these goals without creating a new Federal chartering mechanism. As the hearings before your Committee demonstrated, there is some uncertainty about the number of risk retention groups that will be formed by product sellers. That fact makes the process of staffing a new Federal risk retention office a particularly difficult one: overstaffing or understaffing could easily result. While our original Risk Retention proposal created an office that would be small and fully supported through Risk Retention Act fees, we recognize that small Federal units always have the potential of developing into large Federal bureaucracies.

Of course there are certain advantages of approaching the problem with a Federal chartering mechanism. First, that approach can provide full self-insurance flexibility to product sellers; the administrator of the Federal office can vary capitalization requirements with the amount of risk a self-insurance group wishes to retain. Current state laws and even laws of other nations generally do not provide that precise kind of flexibility in chartering. Second, by having one central office chartering all risk retention groups it would be relatively easy for your Committee and other interested persons to determine whether the risk retention function is properly being fulfilled.

On the other hand, the Staff Working Draft vests responsibility with the parties who have traditionally carried out insurance regulatory functions: the state insurance commissioners. A chartering state will have full regulatory powers over the self-insurance group. If a self-insurance group is formed in anothe nation, individual state insurance commissioners will still have power to impose regulations that are essential for the protection of the consumer, i.e., the Fair Claims Settlement Practices Act. Further, individual state financial interest will be protected as the proposal reserves their right to impose premium taxes on a nondiscriminatory basis.

In sum, there are advantages and disadvantages when one contrasts Commerce's original proposal with the Staff Working Draft. In reviewing the matter as a whole, however, we are able to appreciate the alternative your staff has developed. In that regard, we are pleased to state that this Department fully supports the approach your staff has taken with respect to the formation of risk retention groups. We will work with you to ensure the enactment of a Risk Retention Act in this session of Congress. The Congress and the Administration will then have taken a major step toward addressing the continuing and serious difficulties that have adversely affected American business in the product liability insurance market.

We have been advised by the Office of Management and Budget that there is no objection to the submission of our letter to the Congress from the standpoint of the Administration's program.

Sincerely,

Homer E. Moyer, Jr.,
General Counsel.

The **Chairman**. Prof. Victor Schwartz, the head of the Department's Task Force on Product Liability and Accident Compensation, and other members of his staff, are with us in the audience today and at an appropriate time if any members of the committee have any questions they wish to direct to the Department, we will call on Professor Schwartz.

I may say that Senator Nelson has also contacted me and stated that he supports the concept that we are considering here today, and would like to be included as a cosponsor of this proposal.

Our first witness this morning is Mr. Mike McKevitt, National Federation of Independent Business.

Mr. McKevitt?

STATEMENT OF JAMES D. "MIKE" McKEVITT, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. McKEVITT. Thank you, Senator Cannon.

Mr. Chairman, NFIB on behalf of its more than 610,000 small and independent business members, appreciates this opportunity to offer comments on the working draft of the Product Liability Risk Retention Act of 1980.

The issue of product liability coverage remains a substantial problem for small firms and manufacturers. We commend the committee for recognizing the seriousness of this problem and for proposing a simple, sensible alternative to the current market situation.

Risk retention legislation has been backed by all parties concerned with the product liability problem with the sole exception of some elements of the insurance industry.

Business and consumer groups indicated their support of the basic thrust of this bill on April 22. I am appearing today on behalf of a coalitation of business groups which supports the risk retention concept in general, and this proposal in particular.

Representing both large and small firms, manufacturers, distributors, and retailers, our coalition speaks for over 80 business associations. Many of these organizations are here in the room with me today to indicate businesses' unified support of the committee draft. We have attached to our testimony a list of those business organizations which endorse the new language.

Throughout the past months, the committee has been swamped with letters and information from proponents and opponents of the risk retention bill, each stating their case with great fervor and conviction. We believe the record clearly shows that small firms are still plagued by excessive product liability insurance rates and that, in spite of a temporary softening of the market, they will face even more adverse conditions in the years ahead. If the committee is interested in statistical data to substantiate our position, we will be happy to supply it. As we understand the purpose of this hearing, it is not to restate well-known arguments of support or objection, but rather to specifically consider the merits of the new legislation.

NFIB and those who stand with us today support the committee proposal as a reasonable and a workable approach to improve the current product liability dilemma. We can endorse this legislation because the committee's compromise draft preserves the heart of the original bill while adequately addressing the insurance industry's concerns.

The proposed legislation is very simple. It would preempt those State restrictions which prohibit or retard the creation of product liability insurance risk retention groups. It would impose no new

Federal regulatory apparatus, and it would specifically leave to the States the judgment on what legal requirements to impose upon a risk retention group chartered within the jurisdiction. Thus the importance of the legislation is its recognition that a reasonable alternative to traditional sources of product liability insurance should not be proscribed by State laws.

No attempt is made in the bill to bypass compliance with appropriate State regulations, but only to eliminate multiple conflicting and unnecessary legal requirements.

NFIB appears as an advocate of competitive alternatives. NFIB has stated numerous times before the Congress, including this committee, our opposition to the ever-increasing tendency of the Government to overregulate. Regulation not only imposes direct costs on business, but often works to freeze the market and discourage innovation.

Product liability insurance is as essential to normal business operations as energy and transportation. As consumers of this essential service, business has an important stake in demanding available and affordable product liability coverage. Yet a web of State regulatory requirements has discouraged the formation of new insurance services which could be utilized by business.

At the same time, the rates and terms of presently available product liability insurance options are protected by the very same State regulatory structures. The broad and deep business support for risk retention options is clear testimony that the business community finds its present product liability insurance options unsatisfactory.

What this committee can now do is to insure that the regulatory apparatus does not prevent businesses seeking product liability insurance from pursuing a service more responsive to their needs.

Proponents of regulation, whether on the Federal, State, or local level, often assume that small business men and women need to be protected from themselves; that otherwise they will make poor business decisions.

Based on years of experience with small business owners, I know that their decisions are made on sound principles and with practical judgment. We believe our members should be allowed to test the market place and determine the best way to secure product liability coverage. Business is not asking the Government to dictate what type of insurance it should buy. More importantly, the insurance industry should not rely on the Government to protect this particular form of insurance it sells.

American business is united, Mr. Chairman, in support of the working draft of the Product Liability Risk Retention Act. We applaud the committee's innovative initiative in offering this proposal, and we urge you to give this bill speedy and favorable consideration.

Thank you, sir.

The CHAIRMAN. I may say that this committee, as you know from past experience with the committee, is not inclined to go in the direction of more regulation; but, rather, of less regulation wherever we can do so. That is our basic assumption, and of course we attempt to reduce regulation wherever we can. But I know that the insurance industry will have some concerns, as you have indicated.

Mr. Mack, do you want to go ahead with your statement, sir?

STATEMENT OF JAMES H. MACK, PUBLIC AFFAIRS DIRECTOR, NATIONAL MACHINE TOOL BUILDERS, McLEAN, VA.

Mr. MACK. Thank you, Mr. Chairman.

It is a pleasure and an honor to visit with you again this morning about product liability, and product liability insurance problems.

We have submitted a rather detailed statement for the record which attempts to respond to some of the arguments that some have made in opposition to the very skillful, comprehensive, and helpful draft which your staff has circulated. We are here to support it wholeheartedly.

I think it might be well to draw some distinctions between what occurred in this room on April 22, and what is occurring today. On April 22, you had a number of proponents of the Risk Retention Act as it was then drafted and passed by the House, and you had arrayed against it the entire panoply of the insurance industry and its allies.

Today you have a staff draft which has responded, as you have indicated, to the principal, legitimate, and reasonable arguments which the insurance industry raised against the original bill as it was adopted by the House and as it came over here. It responded by addressing the problem of affordable product liability insurance, by providing for reasonable regulation of risk retention groups by the States, and by removing a Federal regulatory presence—which were the arguments that the insurance industry at that time advanced.

Today we have arrayed in favor of that draft the groups that Mr. McKevitt represents, my own association, some leading representatives of some of the major insurance companies of the United States; you have the insurance brokers, which support the concept, the Reinsurance Association, the risk Insurance Management Society, all in support of the draft.

You do not have appearing here today one of the major insurance associations. You don't have appearing here today in opposition the insurance commissioners. What you have is a couple of insurance associations which still oppose the work that your staff has done. We would hope that as you listen to them, that you would listen carefully to see precisely why it is that they oppose this draft; why they want to maintain an unacceptable pattern of regulation for pooling arrangements of businesses who will deal only with themselves.

I think there is another distinction that needs to be drawn. That is, that we are not talking here about regulating multi-line commercial insurance companies. They quite properly are regulated both in the State of their domicile and in every State in which they do business, because they are dealing and selling a product—a service—to the general public.

Here what we have is an arrangement—a pooling arrangement—of businesses which must go before a regulatory agency in a State or nation, meet all of the regulatory requirements for chartering in that State or nation, still be subject to all of the jurisdiction of that State or nation's insurance regulatory agency, but which would not be subject to overlapping regulation—and in some cases conflicting regulation—in all the rest of the States.

The reason is that the general public with which they are dealing is themselves. It's as though you, and I, and Mike McKevitt decided that we want to pool our risks and sell what amounts to an insurance policy to ourselves. I guess what we are saying to you, Mr. Chairman, is that we neither want nor need nor do we think it is in the public interest to have the multiple layers of regulation and protection from ourselves that some of the opponents of this legislation would foist upon us.

We agree with one of the spokesmen today who says that one person's impediments may be the protection of another person's rights. But in this particular case, the person to be protected and the person who is suffering from the impediments are one and the same. As I said, we neither want nor need the smothering type of protection that the opponents would foist upon us.

Now they have paraded and will parade before you today a set of horribles. They will tell you there is going to be a regulatory vacuum. They ignore the fact that a risk retention group will be regulated and must be chartered in a State or nation, and is dealing only with its own members and therefore need not be regulated in other jurisdictions.

They contend that commercial insurers could somehow qualify as a risk retention group, and you could have big insurance companies that would not be subject to State regulation if you were to pass this bill. Well, that may be true, but it would only be true if a big commercial insurer amended its charter to reflect that it is organized under the language of your bill, "primarily to provide product liability insurance to its members."

We doubt very much that very many members of the alliance, if any——

The **Chairman**. In other words, what you are saying is that an insurance company that is in other types of insurance business could not engage in this business unless it complied with this charter provision?

Mr. **Mack**. The definition of a "risk retention group" in your staff draft, Mr. Chairman, provides that it is "any corporation, or other limited liability association taxable as a corporation, or as an insurance company * * * (A) whose principal activity consists of assuming and spreading all, or any portion, of the product liability or completed operations liability risk exposure of its group members; (B) which is organized for the primary purpose of" providing that coverage; and "(C) which is chartered as an insurance company under the laws of any State or foreign nation; and (D) which does not exclude" others to gain a competitive advantage.

Now I doubt very much that any member of the alliance would amend its charter to reflect that it was organized primarily for the purpose of providing product liability coverage to its members. So that argument, we feel, is without merit.

The **Chairman**. What about the argument that the insurance regulations ought to apply to the risk retention groups in order to protect the businesses against fraudulent agents and risk managers?

Mr. MACK. Mr. Chairman, the risk retention groups are going to be regulated. They're going to be chartered and regulated in the State of their domicile. And if the alliance, or the insurance agents, feel that there is some State or nation that has regulations that are so lax that the public would not be protected, then they ought to come forward and tell you what States those are. Because perhaps something ought to be done about the regulation in those States.

Furthermore, the harm that would occur would befall those of use who form and participate in a risk retention group. Let us say that a fraudulent agent, a fraudulent risk manager comes along and sets up the Shifting Sands Mutual, and the claims are not paid. Who is going to be harmed by that? The people who are going to be harmed by that are the businesses who set up Shifting Sands Mutual, who think that their risks are being covered by Shifting Sands Mutual—and I do not think that any of Mr. McKevitt's members, or any of our members, or any of the other 80 groups' members who support this legislation, are going to participate in that kind of an arrangement. And if they do, the only people who are going to be hurt are themselves.

What we are saying is that we do not think that we need the kind of overregulation in all 50 States that the alliance and others would foist upon us, particularly since a risk retention group would be regulated in its state of domicile.

The opponents, finally, tell you to wait awhile. Don't act now. Let's wait and see what the NAIC does. They are having another meeting in December, and they passed a resolution in June, and so let's wait for them.

Mr. Chairman, I would remind you that in 1971, 9 years ago, NAIC passed a resolution urging the repeal of the fictitious group laws. We are still waiting for that to occur. We are still waiting for that action.

I think it is fair to say that the opponents of this legislation, in urging upon you a deferral of committee action, really want no action at any time at any level. I think it is clear that the reason for their opposition, the reason for the opposition by a few spokesmen for a small segment of the insurance industry, is not that they are afraid of States' rights infringements—you dealt with that in your draft.

What they do not want, Mr. Chairman, is competition. They want things as they are. And this we feel is unacceptable. Your draft will facilitate the information of risk retention groups; it will properly regulate them; it will provide for competition; it will help solve the product liability problem; and we would urge its immediate enactment.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Mack.

Senator Schmitt?

Senator SCHMITT. I have no questions. I am here to learn.

The CHAIRMAN. Thank you very much, gentlemen. We appreciate your being here and giving us the benefit of your views.

Mr. MACK. Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF JAMES H. MACK, PUBLIC AFFAIRS DIRECTOR, NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

The National Machine Tool Builders' Association (NMTBA) is a national trade association representing over 370 American machine tool manufacturing companies, which account for approximately 90 percent of United States machine tool production.

Although the total machine tool industry employs approximately 110,000 people with a combined annual output of around $4.0 billion, most NMTBA member companies are small businesses with payrolls of 250 or fewer employees.

While relatively small by some corporate standards, American machine tool builders comprise a very basic segment of the U.S. industrial capacity, with a tremendous impact on America. It is the industry that builds the machines that are the foundation of America's industrial strength.

We welcome this opportunity to again visit with this Committee on the extremely important issue of products liability.

NMTBA strongly supports the compromise products liability Risk Retention Act draft proposed by the staff of this Committee. It facilitates the formation of product liability risk retention and insurance purchasing groups, while responding to the principal objections of the insurance industry to H.R. 6152, as it was passed by the House.

The draft removes the federal regulatory presence, which was contained in H.R. 6152; and it defers to state regulation by requiring risk retention groups to be formed under the laws of a state or foreign nation, before federal pre-emption of their regulation by other states comes into play.

Proponents of the Risk Retention Act fully expected the insurance industry to "claim victory" and to support the Committee staff's draft. Their objections to the House bill, as expressed in their April 22nd testimony before this Committee, has been met and dealt with affirmatively. Indeed, some in the insurance industry have acted responsibly and in a spirit of compromise.

But others have raised new objections. They continue to greet suggestions of compromise with intransigence. They have rewarded responsible solutions to very real problems with opposition to anything other than the maintenance of an unacceptable status quo.

Their arguments against the Committee staff's compromise draft are totally without merit. Their earlier arguments against the earlier draft did have the redeeming quality of expressing support for state regulation and opposition to a federal regulatory bureaucracy. Although we believed then (and believe now) that their concerns were unfounded, we were willing to concede that they had a justifiable philosophical foundation.

But their objections having been met, and their concerns having been accommodated, these insurance industry spokemen are today engaging in the rankest kind of sophistry. Their arguments, when wrung dry of the crocodile tears they weep an inappropriate and burdensome fabric of state over-regulation, reveal the real purpose for their opposition to legislation facilitating the formation of risk retention groups: They simply don't want the competition these groups would provide.

Why else would they ask this Committee to defer action until the December meeting of the National Association of Insurance Commissioners—knowing, as they must, that the Association has little or no power to remove the state barriers to the formation of products liability risk retention and purchasing groups? They ignore the fact that many of these barriers are legislative in nature, and beyond the ability of the individual insurance commissioners to remedy.

Furthermore, the resolution adopted by NAIC last month does not even deal with risk retention groups. It deals only with the group purchase of products liability insurance. This resolution provides that an advisory committee should investigate impediments to the group purchase of products liability insurance, and that the "NAIC (should) . . . reexamine its position on fictitious group laws . . . as this position relates to the purchase of products liability insurance." This resolution is cited as an indication of the responsiveness of the NAIC to the special problems in this area. However, it must be noted that in 1971 the NAIC recommended that fictitious group laws be abolished. This resolution had little impact, even though many of the so-called fictitious group laws are not legislative enactments but administrative determinations and could be repealed by commissioners without legislative action. If anything, the quoted NAIC resolution and its previous resolution and inaction are indicative of the futility of relying solely on individual state action to remedy the situation. The 1971 NAIC resolution, upon which insurance industry spokemen rely, has gone unheeded for nine years. Their call for a deferral of committee action is in reality a call for no action at any level at any time.

On April 22nd, insurance industry spokemen argue with some justification against the creation of a federal agency regulatory presence in the narrow field of products liability insurance. Today, they argue that a federal law which requires a state to recognize the approval by another state of a products liability risk retention group is somehow inappropriate.

We are told by some insurance industry spokemen, your action to remove state barriers to the formation of products liability risk retention and group purchase arrangements would create a "regulatory vacuum." Some have even argued that the removal of these barriers would encourage a spate of illegal activities by unscrupulous risk managers, group promoters, brokers, and agents. It is incumbent upon those who parade these horribles to immediately advise this Committee which state of states are so lax in their regulation of insurance that such illegal practices would flourish unchecked, were the Committee staff draft to be adopted.

The Committee staff draft exempts no risk retention group from government regulation. It merely provides that a group, which has been chartered by a state or nation and which is subject to the laws and regulations of that governmental entity, may not be regulated out of existence by other state governments.

The opponents ignore the fact that the only risk retention groups eligible for preferential treatment are those which have received their charters from at least one state and/or nation. This charter may be obtained only by complying with all the insurance regulatory laws of the chartering jurisdiction.

Furthermore, a risk retention group's activity outside its chartering jurisdiction can be regulated by that jurisdiction. For example, a licensing jurisdiction can take action against a local insurer who writes risks for insufficient premiums even though those premiums were collected outside of the jurisdiction.

They suggestions that the draft pre-empts civil rights acts and criminal codes is also not in accord with fact. The absence of insurance regulation will not hamper service of process. Such laws do not constitute regulation as that term is used in the Act. Under many state laws, judicial jurisdiction can be obtained over out-of-state defendants who engaged in a single isolated business transaction in that state, if that transaction gave rise to the cause of action. Thus, pre-emption is of no practical consequence with regard to enforcement of judgments.

Some have suggested that commercial insurers who write a predominance of products liability insurance could qualify as a risk retention group and thus become unregulated. This is not the intent of the Act, and it is very unlikely to occur. No commercial insurer would amend its corporate charter to reflect that it is "organized for the primary purposes" of providing products liability insurance to its "members," thus qualifying it as a risk retention group.

Some suggest that states may find this proposal attractive and compete for risk retention group business. Since these same people also represent that the states are, in fact, the most appropriate forum for the regulation of insurance, we fail to see why they are concerned if such competition should result. Or is it another kind of competition which the opponents of this legislation fear?

They suggest that the draft confers a competitive advantage on risk retention groups, since the Act pre-empts laws which relate to capitalization, surplus, deposits, timing requirements, residual market, rate and policy form, signature laws and fictitious group laws. However, this argument ignores the fact that risk retention groups would have to comply with all ordinary regulations in the state or nation of chartering.

The current fabric of state regulation, rather than fostering a uniform regulatory environment, has created a crazy-quilt of varying state laws. Thus, the opponents apparently believe that compliance with one state's laws should not necessarily be sufficient to permit an insurer to do business in a sister state. Which states do these opponents believe have inadequate regulatory mechanisms?

Some insurance industry spokesmen have become advocates of a fabric of regulation, which, although appropriate for overseeing an arms-length business relationship between a multi-line commercial insurer and its customers, becomes a burdensome patchwork of over-regulation when applied to a group of businessmen who seek the option of pooling their own products liability risks and who will deal only with themselves.

Risk retention groups will be chartered by a state or nation, which can impose upon them appropriate capitalization requirements. Also, there is very strong self interest on the part of risk retention group members to adequately capitalize their self-insurance fund. If a risk retention group cannot pay its claims, the assets of individual members will be fully exposed. Opponents' suggestions that such groups either form their own guaranty fund, or use joint and several liability for their participants (i.e., a "reciprocal" format) are almost certain to result in no groups being formed.

Curiously, these same opponents argue that risk retention groups should be required to participate in residual market programs but should be prohibited from participating coequally in state guaranty funds. Who, we might ask, is seeking to confer a competitive advantage upon whom?

Contrary to the assertions of some insurance industry spokesmen, the Committee staff draft, provides that, if a state elects to require a risk retention group to participate in its state guaranty fund, the group's assets could be reached by the state's insurance regulatory agency.

Some opponents suggest that the states should have the right to require risk retention groups to participate in residual market mechanisms relating to products liability insurance. Interestingly, throughout the 1970's, at the height of the products liability crisis, no such residual market mechanisms were proposed. It would appear no more equitable to require risk retention groups to participate in such residual market mechanisms than it would to require product sellers who have no insurance to purchase coverage as a prerequisite to selling their products in a state.

Other opponents argue that, since the Committee draft exempts risk retention groups from state requirements that they participate in residual market mechanisms, states cannot require commercial products liability insurers to participate in residual market mechanisms or otherwise regulate them. This reasoning ignores the express language of the bill defining risk retention groups. To the best of our knowledge no commercial insurer is organized "primarily" for the purpose of providing products liability insurance to its "members."

The opponents of the Committee draft also seek to foist upon risk retention groups state reporting requirements, which they admit are "unnecessary . . .," "can be eliminated . . ." and are a burden upon interstate commerce.

The argue that a risk retention group should be subject to regulation in every state it has members, because the alternative to such regulation would subject to antitrust liability any person who provides services to a risk retention group.

This is clearly not a reasonable interpretation. The antitrust laws would only apply to the extent that the commercial insurer was not regulated by state law by virtue of its specific transaction with a risk retention group. These opponents apparently also assume that risk retention groups will be formed by businesses which will seek to avail themselves of ISO's rates. As a practical matter, groups will be formed and used, precisely because ISO rates are substantially in excess of those indicated by the experience of the prospective group members.

Others contend that the language of the draft would permit discrimination against similarly situated small businesses who could be denied membership in a particular risk retention group for competitive advantages. However, a careful reading shows that this section is not permissive. It does not authorize the exclusion of any person; rather, it prohibits discrimination in one instance. To the extent that these groups are engaged in multistate activity, the Federal Antitrust laws will apply outside of the chartering jurisdiction. Thus, it may well be that a denial of membership of a business located outside of the chartering jurisdiction would constitute a violation of the Federal Antitrust laws. In any event, the threat of the application of the Federal antitrust laws will serve to deter such discrimination.

Finally, opponents of the Committee draft question whether the exemption from multistate regulation should be extended to risk retention groups chartered in a foreign country. Given the opposition by some insurance industry spokesmen to the entire concept of permitting a risk retention group chartered and regulated in one state to operate free of conflicting and onerous regulations in all other states, the answer should be obvious. Insurance industry lobbying at the state level could cause states to make their laws chartering and regulating risk retention groups so burdensome that the beneficial effects of the Act would be undercut. Should this occur, the availability of responsible foreign licensing jurisdictions would become most important and desirable.

Many commercial insurers own at least one foreign insurance affiliate. Should their activities be proscribed? They also engage in fronting activities for Bermuda captives. Should the practice of fronting be abolished by Federal or state statute?

If regulation in some foreign countries is indeed inadequate, we would be pleased to support inclusion of language restricting the use of such "inadequate" jurisdictions as an appropriate chartering and regulatory domicile of risk retention groups.

The opposition of some insurance industry spokesmen extends not only to the opportunity for our members to from competitive options to commercial insurance markets in the resolution of their products liability problems. They also question the need for effectively pre-empting state laws, which prohibit or otherwise restrict the group purchase of products liability insurance.

They oppose the expansion of the pre-emption from state laws to include general liability insurance. Products liability insurance is generally sold as part of an entire insurance package, including comprehensive general liability. Thus, its permitted sale by purchasing groups will merely serve to facilitate the formation of such groups and make them more attractive for insurers to do business with.

On April 22nd, we confessed that, "we fail to understand the intensity with which some insurance industry spokesmen have approached this legislation." In the interim, we have come to understand the reasons for that intensity; and we are sorely disappointed.

For what we had earlier believed was a principled defense of state's rights has degenerated into a misguided attack on competition.

We urge this Committee to adopt its staff's compromise product liability risk retention and group purchase legislation. It will foster competition, will appropriately regulate the interstate sale of product liability insurance, and will provide a meaningful (albeit partial) resolution of American industry's product liability problems.

The CHAIRMAN. We will next have an insurance panel made up of Mr. Donald L. Jordan, assistant vice president, Alliance of American Insurers; and Mr. J. David Rowland, chairman, Federal Affairs Committee, Independent Insurance Agents of America.

All right, gentlemen, which one of you would like to lead off?

STATEMENTS OF DONALD L. JORDAN, ASSISTANT VICE PRESIDENT, ALLIANCE OF AMERICAN INSURERS; AND J. DAVID ROWLAND, CHAIRMAN, FEDERAL AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS OF AMERICA

Mr. JORDAN. I will, Senator.

The CHAIRMAN. All right, sir.

Mr. JORDAN. I am Donald L. Jordan, assistant vice president for the Alliance of American Insurers. We are pleased to testify today on the working draft of the Risk Retention Act.

Our testimony parallels comments made previously to the committee, while providing additional thoughts and information for your consideration.

Mr. Chairman, we congratulate the committee and its staff for its ongoing and diligent efforts to achieve a workable product liability solution with an approach that would meet the concerns of all interested parties, while balancing the competing objectives of product manufacturers, insurance regulators, potential claimants, and commercial insurance underwriters.

We believe Congress has recognized the necessity of maintaining effective insurance regulation over this very complex and volatile insurance line, particularly where group self-insurance is concerned.

In that regard, the Senate Commerce Committee has not rejected the concept of a Federal chartering mechanism because it would undercut and distort essential State regulatory safeguards that are time-tested and proven.

The committee's objective we believe should be to assure effective regulation of product liability groups whose desire is to self insure, based on proven State regulation which protects and provides safeguards to the commercial insurance industry. But this should be accomplished in conjunction with a desire to rationalize State impediments in operating such group insurance entities to the extent that perceived impediments may actually manifest themselves and be counterproductive.

In this context, however, the alliance is convinced that the most recent working draft of the Risk Retention Act fails decidedly to achieve these twin objectives. It lacks essential balance in terms of its design and application and it significantly abrogates State regulatory safeguards which function to assure proper management and financial solvency of all insurance entities.

These regulatory safeguards were developed over many years in response to real-world experience. They have helped the insurance industry to function in a healthy, competitive fashion, while other financial service industries suffered major economic dislocations and required Federal Government assistance.

Effective State regulation is essential in our industry, just as the competitive marketplace is essential. It is essential where the commodity being sold is a promise—a promise to perform in the future where exposure to loss changes with each shift in the common law, and where the extent of these shifts are coupled with escalating claimant awards.

As an example, State insurance capital requirements today help protect a wholesaler by assuring the financial solvency of a manufacturer's product liability insurance coverage for claims and legal costs where such coverage is often the first line of defense against product claims for the wholesaler.

The draft proposal would go far, we believe, in voiding the insurance marketplace of a host of vital protective safeguards, not only for small businesses with product liability problems, but for a heterogenous mixture of economic entities large and small insurer, or manufacturer that qualify as risk retention groups, with application now over not just product liability but comprehensive general liability as well.

I might add at this juncture, Senator, that comprehensive general liability (CGL) covers a whole host of insurance coverages that range far beyond products liability. It (CGL) covers medical malpractice, professional liability, elevator, manufacturers, and contractors, contracts, owners, landlords, and tenants, and so on.

We wish to point out to the committee, Mr. Chairman, that the draft proposal is substantially different in form, substance, and intent in comparison to title II of the original Risk Retention Act, whose primary purpose was to limit State regulation in just two well-defined areas—fictitious group filings, and State countersignature laws.

I might add that the alliance does not support these latter States laws, and although we are not enamored with Federal regulatory intrusion over State insurance regulations, we would not oppose their demise by Federal preemption.

However, the Senate working draft goes far beyond such limited preemption of insurance market regulation as envisioned in title II. Rather, it dramatically restricts the ability of State regulators to fulfill their appointed and elected responsibilities—that is, to protect the constituents of their own State, be they product manufacturers, potential claimants, or commercial insurers.

The draft proposal does this by denying the authority now granted by the States to commissioners to oversee nondomiciliary risk retention groups, commercial insurers, and providers of insurance services who qualify under the act for such exemption.

Because of this 180-degree turn in the structure, scope, and impact of this new working draft, significantly eroding State regulatory safeguards; because as we previously testified before this committee many group insurnace alternatives currently exist and are actively being used by manufacturers in a highly competitive and adaptive market place; and because major questions concerning the exact nature and impact of the so-called impediments have yet to be answered, the alliance cannot support the working draft.

We are convinced that in attempting to silence the problems created by the initial Risk Retention Act, the working draft has created many more problems than it resolves. When speaking of modifying time tested State regulatory safeguards, the approach should be a cautious one. We should seek to trim only those branches which require pruning; not cut down the entire forest.

We recognize that the concepts and issues that are central to product liability insurance regulation and State and group self-insurance are exceedingly complex and difficult for the average person to grasp. We believe that the Senate Commerce Committee's work has been most constructive in fostering an essential dialog between insurers, product manufacturers, and regulators and in advancing the level of understanding on these very difficult and complex issues. We trust that this type of dialog will continue.

Further, the Commerce Committee recognized that some level of regulation of risk retention groups for both chartering and operation is an absolute necessity.

The question we have then is, where and how should the line be drawn for proper and not burdensome regulatory oversight and review? When it comes to insurance regulation as the machine tool builders have testified previously, what constitutes one person's impediments often functions as the only real safeguard for another's rights.

We believe further that it is most constructive for the National Association of Insurance Commissioners to have launched a comprehensive study to identify regulatory protections, as contrasted with impediments which may exist in the operation of risk retention groups.

In addition, the NAIC is developing a comprehensive picture of how risk retention alternatives are being made available and pursued under our current regulatory environment.

Finally, the NAIC is also reevaluating their Unauthorized Nonadmitted Insurance Act, a working model, that should go far in resolving certain questions that exist today on the operation of the nonadmitted insurance market, of which direct placement under risk retention could be a part.

The alliance believes that, to the extent State regulatory impediments may exist which do not have offsetting protective benefits, these impediments be modified or eliminated.

At this juncture, I would now like to introduce to the committee for your consideration a draft put forth by the Department of Labor. This is on Group Self-Insurance under the Longshoremen and Harbor Workers' Act. We were asked to comment on it by the Department of Labor.

My reason for bringing this proposal before the Committee is that it goes quite far in establishing a highly structured regulatory environment, and is diametrically opposed to the approach embodied in the working draft. It dots all the "i's" and crosses all the "t's" in terms of specifying regulatory requirements going far beyond what the States currently require. We bring it to your attention because another arm of the Federal Government has seen fit to propose regulatory requirements that recognize the need for essential chartering and operational standards of conduct.

If existing State insurance laws and regulations are being used to unnecessarily impede the establishment and operation of risk groups, then the alliance believes that the States should be encouraged to amend their laws and regulations to provide a better, more adaptive and realistic balance to their own regulatory programs.

The answer is to adjust and modify State regulation where appropriate, rather than negate them on a wholesale basis by overriding Federal directives.

In conclusion, the alliance commends the Senate Commerce Committee for its diligent work on this highly complex set of issues concerning specialized insurance mechanisms, protections provided by State regulation and competitive influences on our marketplace.

We appreciate the committee's recognition that a new Federal bureaucracy is no answer to the problem. Buttressing our position that Congress not act hastily are recent comments by supporters of the proposal who believe that Federal legislation is in large measure anticipatory and predicated on the potential for deterioration in insurance markets in the future. We are convinced that sweeping Federal legislation to undermine insurance regulatory protections at the State level on a wholesale basis would be a major calamity.

Certainly the recent study commissioned by the NAIC to investigate alternatives available to risk retention groups on perceived State impediments will go far in answering the many unresolved questions that still remain. It is our hope that the Commerce Committee will await completion of that study before any legislative action is taken on this very complex and volatile subject. I am told by the NAIC that that study is expected to be completed by late summer.

That completes my testimony.

The CHAIRMAN. What do you mean by "late summer"?

Mr. JORDAN. I am told, by September.

The CHAIRMAN. September?

Mr. JORDAN. Yes, sir.

[The statement follows:]

STATEMENT OF DONALD L. JORDAN, ASSISTANT VICE PRESIDENT OF THE ALLIANCE OF AMERICAN INSURERS

I am Donald L. Jordan, Assistant Vice President of the Alliance of American Insurers, a major national trafe association of over 130 property and casualty insurance companies who write product liability and other forms of coverage throughout the United States.

The Alliance is pleased to testify today on the working draft of the Risk Retention Act and our testimony parallels and expands upon comments made previously to the Committee.

We congratulate the Senate Commerce Committee and its staff for its ongoing diligent efforts to reach workable product liability solutions to balance the competing objectives of insurance regulators, product manufacturers, commercial insurers and potential claimants in our competitive insurance market. Congress certainly has recognized the need for effective insurance regulation for chartering and operating risk retention groups in conjunction with an interest in rationalizing perceived state impediments to forming such groups.

In this context, however, the Alliance is convinced that the most recent Senate working draft lacks essential balance because it almost totally abrogates existing

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state regulation and protection provisions. These essential protections were developed for the expressed purpose of benefiting insurance buyers, potential claimants and the public at large. As an example, such regulatory requirements protect wholesalers who often rely on a manufacturers product liability insurance as a first line of defense against product claims.

This proposal is also substantially different in form, substance, and intent in comparison to Title II of House bill H.R. 6152 whose primary purpose was to limit state regulation in two well-defined areas through federal preemption (fictitious group filings and state counter signature laws), in order to essentially broaden the scope of the commercial insurance market. However, the Senate working draft under consideration goes far beyond a limited preemption of insurance market regulation because it directly and dramatically restricts the authority of state regulators to monitor and oversee risk retention groups as well as service providers and commercial insurers who qualify. No longer are we looking at regulatory modification as it applies to insurance markets (the essence of Title II). Rather, the working draft would greatly restrict state regulation of insurance markets, licensing and company operations while allowing foreign insurers to operate virtually on an unregulated basis.

Because of this fundamental shift significantly eroding state regulation and because many regulatory and market questions still remain unresolved and unanswered on the effect of perceived impediments, the Alliance of American Insurers cannot support the working draft.

IMPORTANT QUESTIONS, HOWEVER, ARE BEING RESOLVED

We recognize that the concepts and issues which are central to product liability insurance regulation and group self-insurance are exceedingly complex and difficult for the average person to grasp. We believe that the Senate Commerce Committee's work has been most constructive in fostering an essential dialog between insurers, product manufacturers and regulators and in advancing the level of understanding on these difficult and complex issues. We are appreciative that the Senate Commerce Committee recognizes that the creation of a new Federal regulatory bureaucracy is not in our best national interest but that some level of regulation of risk retention groups for both chartering and operation is an absolute necessity. The question at hand then is where and how should the line be drawn for proper and not burdensome regulatory oversight and review.

We believe further that it is most constructive for the National Association of Insurance Commissioners to have launched a comprehensive study that will identify regulatory protections as contrasted with impediments that may exist in the operation of risk retention groups. In addition, the NAIC is also developing a comprehensive picture on how risk retention alternatives are being made available and pursued under the current regulatory environment at the state level. The Alliance believes that to the extent state regulatory impediments may exist which do not have offsetting protective benefits, these impediments should be modified or eliminated.

A PRIMARY FUNCTION OF EFFECTIVE INSURANCE REGULATION: BALANCING COMPETING OBJECTIVES

To gain necessary perspective on this complex subject, the Alliance has attempted in our comments to reconstruct important conclusions reached to date by the Senate Commerce Committee as we seek to identify those characteristics and protections vital to the regulatory system and the need for competitive marketplace alternatives. In that regard, as we have reviewed the work of the Commerce Committee, in particular, and the Congress, in general, it appears that the following tentative conclusions have been reached.

First, that a balance must be struck between the need for effective state regulation and the need to support a healthy adaptive and competitive commercial insurance marketplace.

Secondly, although some industry groups believe that serious regulatory impediments have constrained the formation of risk retention groups, there are significant numbers of alternative risk retention group approaches which exist today that have been actively utilized by literally hundreds if not thousands of separate groups.

Product liability risk retention groups all require certain safeguards to protect their members, potential claimants and the public at large from financial insolvency, unpaid claims, poor management and unfair discrimination and this has been recognized by the Committee.

The development of workable risk retention approaches depends on the existence of an efficient regulatory system coupled with the existence of a competitive com-

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mercial market which working jointly can efficiently sort out industry loss exposures, spread risks, promote loss prevention and provide essential protection at adequate rates.

Essentially, what we have then is a valiant attempt on the part of the Commerce Committee to consider competing objectives such that risk retention groups will function as intended for the benefit of the public at large and for their own members. This we submit is the very same type of problem faced daily by state insurance regulators who must sort out conflicting objectives to protect their various constituencies who interact and rely upon them. For instance, encouraging the pricing of insurance that is affordable to the public can in certain volatile lines of insurance directly conflict with the objective of safeguarding financial solvency of the insurer writing that coverage.

Establishing regulatory policies which balance competing interests for the benefit of the various constituencies who rely upon such regulations and the public at large is the cornerstone of our state regulatory insurance system. It is for this reason that we believe Congress as well as industrial groups can learn a great deal from the state insurance regulators who over the years have become adept in handling such competing objectives.

We hope that the Senate Commerce Committee will acknowledge the importance of recognizing competing objectives and will realize that legislative proposals which substantially disregard or override certain objectives place the entire insurance mechanism out of balance and over the long run work to the detriment of the insurance marketplace and all its constituents. The Senate's draft risk proposal has this very shortcoming in that it undercuts the application of existing state regulation in the operation of risk retention groups to such an extent that their financial solvency and ability to pay claims will be seriously compromised.

THE THIRD PROPOSAL

In reviewing the Congressional activity over the past year, three separate and distinct risk retention proposals have been offered by the federal government. The first approach developed by the Department of Commerce created a new regulatory bureaucracy in competition with the states and proposed a very broad yet rather undefined regulatory role for the Secretary of Commerce in managing risk retention groups.

The second proposal developed in the House of Representatives was a direct outgrowth of the DOC proposal but with significant changes made to more adequately define and supplement broad regulatory responsibilities contained in the former approach while still relying upon a federal regulatory presence.

The third approach embodied in the working draft is taking the exact opposite approach of the other two by totally deleting the federal chartering mechanism while substantially abrogating existing state regulations as they apply to operating insurers not only on new risk groups formed but existing product liability insurance market entities as well.

We are convinced that none of these three proposals properly balance the time tested objectives of state regulation or the Senate Commerce Committee's objectives themselves nor would they be in the public interest.

A PHILOSOPHICAL DILEMMA

In developing this most recent risk retention proposal, the Senate Commerce Committee may not fully realize or appreciate how such legislation contradicts and undercuts the Commerce Committee's own position reaffirmed recently in solid support of state regulation of insurance. Specifically, the Senate Commerce Committee in its FTC proceedings voted forcefully in this session of Congress to support the McCarran-Ferguson Act and our system of state insurance regulation. Yet, the current risk retention proposal would effectively quarantine a host of product liability insurance activities from almost all state regulatory oversight. In some instances, no regulatory oversight whatsoever would be provided in the event foreign or alien insurers were imported into the United States to write product liability coverage.

Let us look for a moment at the possible mischief which could easily occur under the provisions of the Senate Commerce Committee working draft were it to become law. We hasten to add that this scenario is not "far-fetched" in any way for we live in an international insurance community where great changes are occuring in the marketplace particularly in the self-insurance arena. In setting forth this scenario, the Alliance does not wish to cast aspersions on the risk management community at large. Our intent is simply to demonstrate that the potential for actions not in the public interest are manifold under this current proposal where existing state regulatory protections have been effectively circumvented.

Let's suppose for example that an unethical risk management consultant wishes to capitalize on the regulatory void created by the risk retention proposal. For a healthy management fee, a captive insurance entity is established on a skeletal basis offshore somewhere under the auspices of a foreign government. The sum and substance of insurance regulatory oversight is limited to the initial payment of a modest filing fee for incorporation.

Let's suppose further that the risk consultant who organized this "captive" prints policies and establishes a line of credit with a foreign bank which miraculously becomes the capital/surplus position of the new insurance entity. Who is to check on the veracity of the claimed capital and surplus position of this captive insurer in the public interest? Who will be responsible to assure that the planned investments (if any) are made in prudent areas or that risk transfer approaches are sound and workable?

The captive insurer's organizers then proceed to sell insurance policies in the United States to high risk product manufacturers at insurance rates which bear little or no relationship to loss exposures or claim experience. Although premium taxes are paid to the state regulator, premium dollars are funnelled offshore as collected. Under this scenario state insurance regulators would be effectively barred by the Risk Retention Act from exercising almost all regulatory oversight save for fair claim settlement practices and the collection of premium taxes from the alien insurer. Even here, exercising authority over claim settlement practices would be significantly delayed until claims became unwieldy over the course of time.

Look for a moment at the range of fundamental state regulatory responsibilities that would be abrogated by the Risk Retention Act in this instance:

Filing of Annual Reports and financial information by the captive;
Capital and surplus requirements;
Filing of contracts and forms to assure that coverage is consistent with rates and rating plans;
Regulation over rebates;
Examination of market and financial conditions on a periodic basis;
Oversight and scrutiny of investment of policyholder funds and loss reserves;
Payment of commissions and licensing of agents;
Rate regulatory laws (that rates be adequate, equitable and non-discriminatory);
Rate filings and statistical plans;
Special reporting; and
Complaints.

We would be pleased to provide to the Commerce Committee an expanded memorandum on all these points if it is desired.

So under the Risk Retention Act financial solvency, adequacy of reserves, rate adequacy and unfair discrimination and coverage parameters would be almost totally devoid of regulation and such protections would be lost to the product manufacturing purchasing group who unwittingly was duped to purchase coverage in good faith. Under such circumstances, state regulators would themselves find it difficult if not impossible to exercise authority to assure that fair claims settlement practices would in fact be adhered to or that premium dollars could be found to pay outstanding claims.

In the event that some raise a skeptical eyebrow regarding this "scenario," we would refer the Commerce Committee to the experience in the State of Florida after the Employee Retirement Income Security Act (ERISA) was passed when a number of unregulated insurance entities sprang up overnight, creating a literal regulatory nightmare as participants in these insurance programs were without the benefit of any regulatory protection whatsoever.

UNNECESSARY IMPEDIMENTS OR ESSENTIAL MINIMUM PROTECTION

It is important that proponents of this Risk Retention proposal recognize that when it comes to insurance regulation, what constitutes one man's impediments often functions as the only real protection for another man's rights. Some believe for example that state minimum capital and surplus requirements are an impediment which inhibits the formation of insurance entities and unnecessarily constrains product manufacturers from organizing their own insurance companies. The Alliance would be the first to agree that capital and surplus requirements must be realistic and relevant to the nature and extent of loss exposures to be underwritten and retained. It is only when the guideline limitations or minimum requirements established by the states are out of step with reality that they should be considered as impediments, however.

When effective state regulation over the operations of product liability risk retention groups is circumvented, look at the "witch's brew" that is created. We begin with product manufacturers and distributors, some of whom believe rightly or wrongly that they collectively may be able to underwrite and shift their own loss exposures internally at less cost than can commercial insurers. If the product manufacturers are correct, and prudent underwriting and fiscal management is practiced, this is all well and good, part of our free competitive commercial insurance environment.

If they are wrong, however, if such groups are poorly managed, underfinanced or improperly structured, capital and surplus, loss reserves and premiums could individually or collectively be inadequate to cover outstanding claims and expenses. In this instance, not only does the insurance business at large receive a black eye, but the public is not properly served and the regulator is blamed for not doing his job—because he can't!

We note further that the nature of the product liability risk is devilishly complex, particularly to the uninitiated as loss exposures often change with each new shift in the common law. Unless experienced risk managers or insurance brokers properly manage the risk retention program, it can progressively move out of step with reality. Certainly, product manufacturers should be acknowledged as having requisite experience and resources to manage affairs in their own particular industry sectors. However, achieving proper understanding and technical knowledge of insurance markets, rating programs, financial requirements, loss and risk shifting techniques, and even incorporation questions is quite another cup of tea. Isn't it logical to assume that certian fundamental bases may not be touched by some manufacturer/insurer groups and that corners may inevitably be cut without the benefit of state regulatory monitoring programs and state guidelines, particularly when the immediate objective of many manufacturers is to reduce insurance costs over the short term?

We find it rather ironic that some members of Congress today criticize the insurance industry for too little state regulation, while others tell us that existing regulation is too onerous. Perhaps being in the middle on this question is the right place to be.

If existing state insurance laws and regulations are being used to unnecessarily impede the establishment and operation of risk retention groups, then we believe the states should be encouraged to amend such laws and regulations so they will provide a better, more adaptive and realistic balance to their own regulatory programs. The answer is to adjust and modify state regulations where appropriate rather than to negate them on a wholesale basis by an overriding federal directive.

OTHER COMMENTS ON THE WORKING DRAFT

A number of legal definitions adopted in the draft proposal differ significantly from stated practice or are so broad that questions arise as to their application and impact. For example, the term "risk retention group" itself includes not only self-insured groups of product manufacturers but literally any insurer whose principal activity includes spreading all or a portion of its product liability or completed operation risk exposure. Any mutual or stock insurer who writes a predominance of liability coverages such as products liability could qualify itself as a risk retention group. Is it the intent of the bill to treat commercial insurers in this fashion?

The term "group members" is undefined in the bill and it appears that the term could include not only policyholders in the case of a mutual insurance company but perhaps even the stockholders of a stock insurer.

Another example—the application of the term "purchasing groups" is equally broad. A corporation with a risk management division could be construed as a purchasing group if it had a number of manufacturing divisions or product lines which had as one of its primary purposes the purchase of product liability or completed operations insurance on a group basis. Was it the intent of the Senate Committee to treat a corporation with subsidiaries as a purchasing group?

We must also question how the term "charter" should apply. As it is currently used, charter signifies the state in which the insured group is domiciled and the exemption would apply to all foreign (non-domiciled) insurers. Virtually any foreign insurer who provides insurance or related services would be exempt from all state regulations except as to those regulations applicable to claim settlement practices and state premium taxation. Further, if this occurred then the McCarran-Ferguson Act itself would no longer shield from antitrust legal action all those activities which are exempt now under the auspices of state regulation. We can only conjecture how an existing insurer providing services or insurance coverage to a risk retention group would be treated sans McCarren-Ferguson were the risk retention proposal to become law.

With respect to state guarantee funds, the states are placed in a classic catch-22 situation. The risk retention proposal makes it possible for a state to require participants under the bill to belong to the guarantee fund as long as such participation is on a non-discriminatory basis. States have the authority to ensure that risk groups would receive the benefits of guarantee fund protection in recognition of the need to protect third party citizen constituents of that state. Yet, the Alliance would be in opposition to such an approach because of the lack of the state regulatory oversight. In effect, the commercial insurance community would be expected to function as a safety net to bail out captives operating essentially in an unregulated market.

Further, when a guarantee fund is in operation, the regulator's hands would be tied as he would not be able to get at the assets of the risk retention group to help pay claims. If the states did not utilize the guarantee funds available to them as they relate to risk retention groups, they could, of course, be criticized as being unresponsive to the needs of their own citizens. So there you are. A classic catch-22 situation facing the state regulator. Any way he turns, somebody loses.

Subparagraph 3 of the risk retention proposal exempts risk retention groups from any law or rule requiring such a group to participate in residual market mechanisms unauthorized or established under state law. If the interpretation is to apply the term "risk retention group" to include any product liability insurer, and we believe it is, then product liability insurers could no longer be required by the states to participate in state residual market mechanisms or in state reporting programs set up to monitor product liability claims, premiums, etc.

Was it the intent of the risk retention proposal to apply the term "insurance-related services" to adjusters, insurance agents, risk consultants, loss control specialists, actuaries, claim attorneys and so on, all of whom provide insurance-related services to the risk retention entity? If these groups are to be so included, would not all of them be exempt from the laws which otherwise discriminate against them at the state level?

With respect to the use of Insurance Services Office advisory rates filed on a countrywide basis another question arises. If an existing commercial insurer by providing either insurance services or coverage to a risk group is no longer subject to certain state insurance regulations, would not that insurer be subject to full antitrust action without protection from the McCarren-Ferguson Act? Would not this situation also include the potential for legal challenge for using rates and rating services developed in concert with other insurers?

As presently drafted, the proposal would not only shield new risk retention groups from state regulations, but also could eliminate the impact of state regulations for many existing insurance companies and service providers. We believe that this weakness is glaring.

As the proposal is currently written, conditions could easily arise where states might use minimum regulation as a carrot to compete for the establishment of insurance group chartering business. Benefits to the states in the event such chartering activity increased would affect funds deposited in local institutions, the generation of state premium taxes, real estate purchases, increased employment, and so on. On the other hand, domiciliary states could have disruptions as well as certain costs which would have to be absorbed to handle increases in chartering and monitoring requirements as the risk retention groups establish themselves in that state of domicile, not to mention the catch-22 problem with state guarantee funds.

IN CONCLUSION

The Alliance commends the Senate Commerce Committee for its diligent work on this highly complex set of issues concerning specialized insurance mechanisms, the protections provided by state regulation and competitive influences of the commercial insurance marketplace. We appreciate the Committee's recognition that a new federal regulating authority is no answer to this problem. Buttressing our position that the Congress not act hastily are recent comments by supporters of the risk retention proposal who state that the need for federal legislation is in large measure anticipatory and predicated on a potential for deterioration in market conditions in the furture.

We are convinced that sweeping federal legislation to undermine regulatory protections at the state level on a wholesale basis would be a major calamity. Certainly, the recent study commissioned by the NAIC to investigate the alternatives available to risk retention groups and perceived state impediments to establishing such mechanisms will go far in answering many of the unresolved questions that still remain. It is our hope that the Commerce Committee will await the completion of that study before any legislative action is taken on this very complex and volatile subject.

The **Chairman**. All right, Mr. Rowland.

Mr. **Rowland**. Thank you, Senator.

Mr name is Dave Rowland. I am an independent property and casualty insurance agent affiliated with CRB Insurance and located in Racine, Wis. I have appeared before you in the past and tried to qualify myself as coming from a small industrial town out in the heartland of America.

For the record, I would like to reiterate that I represent the IIAA, a national trade association representing approximately 126,000 licensed independent property and casualty insurance agents, and 250,000 insurance persons located in virtually every community in the country.

My prepared remarks have been turned over to you. I would like to just make some random comments, if I might, in regard to this.

The **Chairman**. All right, sir.

Mr. **Rowland**. And perhaps maybe we will get more light shed by some questions which I hope will be forthcoming.

First of all, let me state that we rocognize and sincerely applaud the commendable efforts of the members of the staff and the Committee on Science, Commerce, and Transportation in striving for a reasonable bill attempting to balance the legitimate concerns of the contending parties. We thus offer this statement as a constructive response to the changes evidence in the new draft.

I would just like to call the attention of the committee to a little bit of history. I know it perhaps is redundant, but let's remember that the initial thrust of the risk retention concept was conceived in an era of panic-pricing and availability problems. Even the strongest proponents said it was band-aid treatment and that the real problem was the tort system.

Since that time, a new phenomenon has appeared on the scene—captives, both on and offshore have been formed. Also, the commercial market has become more responsive and realistic. Why should we now create a new type of insurance company—which in effect is what we are doing here—exempted from all or most regulation which other insurance mechanisms must adhere to, and expect the present marketplace to continue to be competitive?

The danger as I see it is the possibility of skimming off those better risks. Take the example of sporting good manufacturers, in association assembled they could say: Well, could say, "well, OK, if you manufacture gold tee's, we are going to write all of you guys; if you manufacture putters and nurf balls, that is fine; but if you manufacture football helmets or trampolines, hey, wait a minute, that is something we don't want to be involved with."

So I am not sure that we are going to address the specific problem of the real availability and pricing of the hazardous products that are out there waiting to be insured, waiting for somebody to pick up the pieces.

Let me state that I am probably the only guy in this room, the only person that's testified before this committee, who has ever sold a policy. I really truly represent the consumer. The consumer pays my commission. I don't get a dime from insurance company, X, Y, or Z. I sell a policy. I receive a commission from the sale of that policy from my customer, and I truly represent that person.

I have appeared in the State of Wisconsin. I worked actively on the MAP program, which is the market assistance program. I have worked actively in the legislative council, which is designing and hoping to design a model products liability which has been recommended to the legislature, and thanks to Mr. Victor Schwartz for having come out and appeared before us at that time.

But I keep hearing, and it keeps ringing true in my mind, the statements made by not only Professor Schwartz but by Senator Culver, who talked to us about 2 or 3 years ago: This is a Band-Aid kind of a solution. The cut is not bleeding now. I do not think at this point we are going to really need the Band-Aid.

As we have pointed out repeatedly in our testimony in both the House and Senate, current State laws, to the best of our knowledge, do not impede the establishment of products liability self-insured groups, or group insurance plans. There are hundreds of them available today in the current marketplace. And I represent companies, and have sold these plans to members of Jim Mack's organization, and to the wholesalers, and to other people in our community and throughout the State of Wisconsin.

The preemption of State regulation contained in the Senate draft is really too broad to accomplish the stated goals of removing the perceived impediments. I think it is very laudable that this attempt has been made, but it just wipes out virtually all regulation, with the exception of two areas that the State can come in and they can talk about fair claims' practice, and to collect their tax.

The state insurance departments do much more than that. Their primary goal is to protect the public. Now if a risk retention group is formed and an insurance buyer, one of the members of the associations, buys that product thinking that he is protecting the assets of his corporation, and because it has been set up on a basis that is shaky or that is faulty, that company goes under, he may well find himself out of business in short order because he has put his assets for his company on the line.

So what we are really saying is: Caveat emptor! Let the small buyer beware of what he is doing. If he does make a mistake, if the group is ill-conceived and he goes under because of it, where is the public being served in that case?

[The statement follows:]

STATEMENT OF J. DAVID ROWLAND ON BEHALF OF INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

My name is J. David Rowland. I am an independent property/casualty insurance agent affiliated with CRB Insurance located in Racine, Wisconsin. I appear before this committee today in my capacity as Chairman of the Federal Affairs Committee of the Independent Insurance Agents of America, Inc. (IIAA). I have previously addressed both this panel and the House Subcommittee on Consumer Protection and Finance with reference to earlier versions of the Product Liability Risk Retention Act and I welcome this opportunity to elaborate upon the new "staff working draft."

For the record, let me state that IIAA is a national association representing approximately 126,000 licensed independent property/casualty insurance agents and 250,000 insurance persons located in virtually every community in the United States.

We recognize and sincerely applaud the commendable efforts of the members and staff of the Committee on Commerce, Science and Transportation in striving for a reasonable bill, attempting to balance the legitimate concerns of the contending parties. We thus offer this statement as a constructive response to the changes evident in the new draft.

In general, we find a number of the revisions to be both significant and praiseworthly. In particular, the deletion of the authority granted to the U.S. Department of Commerce, in the House passed bill, to certify and regulate risk retention groups removes one of its most objectionable provisions. As we have testified repeatedly, this federal regulatory power would not only duplicate established state regulation in this area, it would directly contradict the statement of public policy contained in the McCarran-Ferguson Act which stresses the propriety of state regulation.

However, while we favorably note the removal of the physical presence of a federal regulatory body, we continue to have serious reservations about the broad preemptory language contained in this draft. Indeed, the implications of authorizing the insurance laws and regulations of any single state (or foreign country) to prevail in all other state jurisdictions opens vistas not contemplated by the House passed legislation and raises questions not previously studied. Our initial analysis finds this to be a confusing and troublesome concept which might easily undermine state regulation and frustrate the intent of the McCarran-Ferguson Act.

In itemizing IIAA's specific concerns wih this draft, we must advise that while some of our evaluations may be tentative or speculative in nature they are based upon the best information available to us at this time.

(1) As we have pointed out repeatedly in our testimony in both the House and Senate, current state laws, to the best of our knowledge, do not impede the establishment of products liability self-insured groups or group insurance plans. However, as a result of the concerns that have been raised, the National Association of Insurance Commissioners has made a commitment to take an indepth look to identify whether there are "true" impediments to the establishment of self-insured groups and group purchase of product liability insurance. We believe Congress should defer taking action until the NAIC has completed its study of these issues. We also believe there is a commitment within NAIC that if real impediments are identified, it will take prompt action at the state to rectify these impediments.

We should note here that IIAA has formally advocated a policy that countersignature laws, specifically, are anachronistic and should be repealed through state action. (See appendix No. 1.) However, even here there is no evidence that these laws seriously retard in any material way the ability of group insurance programs—or risk retention groups—to operate on an interstate basis. Quite the contrary, the existence of such groups has already been well documented.

(2) The pre-emption of state regulation contained in the Senate draft is entirely too broad to accomplish the stated goals of removing perceived impediments. Rather than pre-empt all state regulation except for two narrow areas, the approach might well be to identify true impediments and then pre-empt only those state laws creating the impediment. The over-broad pre-emption leaves the states in a position unable to protect the legitmate interests of their citizens. The result would be the creation of a regulatory vacuum.

As currently worded, Section 3(a)(1) would prohibit any regulation of a "risk retention group" "outside the place in which it is chartered" except with respect to claim settlement practices and premium tax laws. The pre-emption would not only apply to the risk retention group itself but to any person that sells such services or provides management services to the group. The net result would be that any state in which the risk retention group is operating, other than the chartering state or country, would not be able to police the practices of the group to make sure that unfair or deceptive insurance practices, sales practices, advertising, or management services are provided. Most important, the state would not even have the power, if the group's rates were either excessive or inadequate, to force their correction, or to take steps to assure the group's continued solvency, thereby forfeiting the security that the small businessman needs from such a group.

The abuses that will result in time from this vacuum in regulation will inevitably force federal regulation of these groups—initially, perhaps as a result of litigation in federal courts, but ultimately via congressional action—a result we firmly oppose because of our strong belief that state regulation is more effective.

Even if the language of the bill were amended to permit the chartering state to attempt to regulate the operations of these groups in other states, we question whether such authority would go unchallenged. While there is precedent for a state's laws, in particular circumstances, to have such extraterritorial jurisdiction, the Supreme Court has raised serous questions about the "unwisdom, unfairness and injustice of permitting policyholders to seek redress only in some distant state where the insurer is incorporated." (*Federal Trade Commission* v. *Traveler's Health Association*, 362 U.S. 293).

In the same case the Supreme Court buttressed this argument by referring to the legislative history of the McCarran-Ferguson Act and noting that:

"One of the major arguments advanced by proponents of leaving regulation to the states was that the states were in close proximity to the people affected by the insurance business and, therefore, were in a better position to regulate that business than the Federal Government. Such a purpose would hardly be served by delegating to any one state sole legislative and administrative control of the practices of an insurance business affecting the residents of every other State in the Union."

Indeed there are numerous specific references in the legislative history proscribing extraterritorial rule; as for instance one Senator's remark that: "Nothing in the proposed law would authorize a state to try to regulate for other states." (91 Cong. Rec. 1483).

Moreover, insurance departments cannot be expected to have either the resources or the controls set up to monitor the activities of such groups in other states. A recent controversial GAO report—entitled Issues and Needed Improvements in State Regulation of the Insurance Business—asserted that some state insurance departments are currently understaffed and underfunded. Such states obviously would be under considerable strain if required to monitor insurance activities in 49 additional jurisdictions.

(3) The Senate staff draft would permit individuals to solicit participation in "risk retention groups" who are not licensed outside the chartering state (Section 3(a)(1), and would allow agents licensed in any one state to solicit insurance for a "purchasing group" in any of the other 49 states without procuring a license in that state (Section 4(a)(3).) We firmly believe that the right of each state to require licensing of the individuals that solicit participation in risk retention groups or group insurance within its borders be preserved so that the state will maintain adequate control over its agents, brokers, and other sales people to prevent unprofessional sales practices that are injurious to the small businessmen this bill is designed to protect. Such a result would reflect adversely on an industry seriously committed to upgrading its professionalism and service to the public.

Congressional committees have recently heard testimony raising allegations that unscrupulous, "hard sell" techniques have been used to promote Cancer and "Medigap" insurance to the elderly. With reference to commercial marketing for risk retention groups such hard sell tactics may not be a factor, but there are other potential abuses such as:

(1) Deceptive sales practices which could include misleading the insured about benefits and obligations.

(2) Misappropriation of premiums and other financial abuses.

(3) Unfair trade practices such as tying the marketing of one product or service to another product or service offered by the representative; etc.

It must be emphasized that IIAA could never knowingly endorse any legislation—regardless of its intent or any other meritorious features—that unwittingly opens the door to such irresponsible or unprofessional conduct.

(4) Section 3(a)(2) provides the basis for a state to require, "on a nondiscriminatory basis" a risk retention group to participate in an "insurance insolvency guarantee fund." This is a laudable first step to protecting both risk retention group members and consumers in general from the consequences of insolvency.

However, it is unclear as to whether risk retention groups would be compelled to participate in the guarantee funds in all jurisdictions in which they have members or whether this is solely the prerogative of the domiciliary state. Would participation, even on a non-discriminatory basis, be compulsory or discretionary? One way to further protect the claimant and better ensure payment for legitimate claims would be to have members of risk retention groups joint and severally liable for claims.

(5) Section (3)(a)(3) provides that risk retention groups shall not participate in residual market mechanisms established under state law. We can see no reason to exclude these groups from residual market mechanisms to fullfill their obligation to the same extent that other products liability insurers do.

It is important to point out that many of the mutual and reciprocal companies in operation today originated in the same way as is proposed for risk retention groups, and their operations in time will be identical. Given the broad definition of "risk retention group" in the draft, it is likely that several of these in time will be considerably larger than good size commercial insurers today. Moreover, there is nothing in the draft to prevent the grouping of varied kinds of businesses in one "group" (that is, non-homogeneous risks). Thus, we are not just talking about the formation of a few association groups or captives. Formation of substantial commercial insurers are likely, calling themselves "risk retention groups", able to do business on a preferred basis over multi-line companies. The special privileges are unjustified and unfair.

(6) Both the section on risk retention groups and purchasing groups prohibits any state laws that ". . . otherwise discriminate against such a group or members thereof." The meaning of these sections are entirely unclear: What is meant by "discrimination", and discrimination in reference to what? Is it in reference to other group programs, other insurance companies, resident insurance companies? Unless further clarified, this would predictably lead to inconsistent interpretations by the several states and thus to substantial litigation.

(7) Section 2(a)(4)(D) would permit rank discrimination against similarly situated small businesses who for some reason or other are denied membership in a particular risk retention group. Businesses perceived to present a higher risk could be excluded from the group, and the group could justify it under the current wording arguing that the exclusion was not "solely" to provide the other members a competitive advantage. But, such a competitive advantage to members could certainly be the net result of such exclusion. Some standard must be included that assures fair treatment of all potential members of such groups.

(8) The definition of "purchasing group" contained in Section 2(a)(5) sanctions the pre-emption of state law with regard to any group that has as one of its purposes the purchase of products liability insurance. Thus, a group that purchases products liability insurance would be exempted from state regulation with regard to any of its group insurance programs, and its agents, insurers and suppliers of management services would be exempted with regard to products liability and other liability insurance. We know of no evidence that has been produced in the hearings on this issue that arguably justifies extending the pre-emption of state law to lines other than products liability.

In conclusion, we must stress that no persuasive evidence has been produced that documents the necessity for legislation preempting state regulatory authority in this area. On the contrary much testimony has been produced that clearly describes an environment currently conducive to the formation of association captives, "purchasing" (or safety) groups, etc.

If, however, after additional study the Committee remains convinced as to the necessity of federal legislation in this area, it would be well to consider a far narrower document. As we have indicated above, the ambiguous, and broadly pre-emptive language contained in certain provisions of the draft would result in unneeded havoc, extensive litigation and, ultimately, more pervasive federal involvement.

We might also suggest that there are alternative approaches to carry out the intent of this legislation. For instance, might not this committee consider drafting a model captive insurance law for adoption by the several states. This is an approach that has been widely endorsed by advocates of tort reform. Such an approach would retain the benefits of state regulation of insurance while enabling manufacturers to facilitate the establishment of self insurance cooperatives.

In our testimony on April 22, 1980 we noted the diversity and conflicting nature of the testimony that has been submitted to your Committee. We respectfully suggested that the committee consider commissioning an "independent study" in order to reconcile this contradictory information. We were pleased that the Committee prompted the Department of Commerce to conduct a forum for this express purpose. However, as you are aware, the Department of Commerce has taken a leading advocacy role during the deliberations of this product liability insurance issue and may not be in the best position to be a dispassionate mediator. Now, especially considering the new vistas opened up by this staff draft, we would renew our request for further investigation.

We are also well aware of the extensive efforts of yourself, your colleagues and the Committee staff to further research and refine this legislation. We will, of course, continue to make ourselves available to assist you in achieving your goal of arriving at truly responsive and responsible legislation.

Countersignature Laws

BACKGROUND

Countersignature laws require that business produced outside the state be countersigned by a resident agent of the state where the business is located. Many of these statutes were enacted at the turn of the century. At that time, state legislators believed that countersignature laws would provide protection to the local insured on the premise that the countersigning resident agent would assure that the forms and conditions of the policy conformed to the laws and practices of the locality. In addition, the insured would have recourse in the event of a claim by suing the out-of-state insurance company through its resident agent.

The resident countersigning agent also benefits under the countersignature laws, since in many instances the countersigning agent receives part of the commission on the business produced.[1] Consequently, these statutes often have the effect of protecting resident agents from competition since out-of-state agents are discouraged from producing business in other states because of the inefficiency associated with coordinating the business with the resident agent, and the potential loss of part of commission.

The legality of countersignature laws was confirmed by the United States Supreme Court in *Osborn* v. *Ozlin*,[2] which upheld the Virginia countersignature statute that mandated division of commissions between resident and out-of-state agents. However, the *Osborn* decision was rendered four years before *United States* v. *South-Eastern Underwriter's Association*,[3] which found insurance to be interstate commerce. Accordingly, there is no assurance that a countersignature law would withstand a similar challenge today.

CURRENT NEED FOR COUNTERSIGNATURE LAWS

With the enactment of the McCarran-Ferguson Act,[4] the insurance industry has become highly regulated on the state level. In contrast to conditions existing 70 or 80 years ago, states have the regulatory capability to assure that business produced by an out-of-state agent conforms to local laws and practices without resorting to the countersignature requirement. In states that do not require the physical countersignature of a policy, the need to engage a resident agent is even more questionable because often the countersigning agent will not even see the policy to examine it. To the extent that the resident agent is receiving a commission under these circumstances, the insured is paying for services that he is not receiving. The need to provide the local insured with an adequate recourse in event of a claim against the out-of-state insurance company through the countersigning resident agent is dubious since state insurance laws extend such protection by requiring out-of-state insurance companies to name the state insurance commissioner as their agent-in-fact.

Therefore, it appears that the rationale for states retaining countersignature laws is to prevent the local agent from losing local business to out-of-state agents.

SURVEY OF STATE COUNTERSIGNATURE LAWS

Increasingly, states are recognizing that countersignature laws are anachronistic. The following states no longer require countersignatures:[5] California; Colorado; Connecticut; Michigan; Minnesota; New Mexico; New York; Oregon; Tennessee[6]; Vermont and Washington. The following states have waived their countersignature requirements to the extent of reciprocity[7]: Delaware; Iowa; Maryland; Utah and Virginia. The following states have retained their countersignature requirements: Alabama; Alaska; Arizona; Arkansas; District of Columbia; Florida; Georgia; Hawaii; Idaho; Illinois; Indiana; Kansas; Kentucky; Louisiana; Maine; Massachusetts; Mississippi; Missouri; Montana; Nebraska; Nevada; New Hampshire; New Jersey; North Carolina; North Dakota; Ohio; Oklahoma; Pennsylvania; Rhode Island; South Carolina; South Dakota; Texas; West Virginia; Wisconsin and Wyoming.

ANTI-COMPETITIVE EFFECT RECOGNIZED BY THE FEDERAL GOVERNMENT

The anticompetitive aspects of countersignature laws have been recognized by the Federal government. A recent Department of Justice study on insurance characterized state countersignature laws as "another form of artificial restraint on the marketing of insurance".[8] Similarly, in a statement accompanying the proposed Product Liability Risk Retention Act of 1979, which grants the Department of Commerce regulatory authority for product liability self-insured groups, countersignature laws were cited as one justification for the act's passage.[9] Accordingly, state regulatory excesses such as a countersignature law provides a forceful argument for increasing federal regulation of insurance.

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[1] Many but not all states with countersignature laws require that the out-of-state agent share part of his commission with the resident agent.

[2] 310 U.S. 53 (1940).

[3] 322 U.S. 533 (1944).

[4] 15 U.S.C. § 1011 et. seq.

[5] Except some of these states have retaliatory provisions which require countersignature if the nonresident agent's state has a countersignature requirement.

[6] Required only for fidelity, surety, bonding (except bid bonds).

[7] These statutes eliminate or reduce the countersignature requirement depending on the countersignature requirements in the nonresident agent's state.

[8] "The Pricing and Marketing of Insurance," A Report of the Department of Justice to the Task Group on Antitrust Immunities, January 1977, P. 328, N. 584.

The increasing criticism of these laws has led the National Insurance Producers Council, representing every national producer organization, to take a position urging the repeal of the countersignature laws.

In the long term, state regulation of the insurance business will prevail only if steps are continually taken to improve it where possible, including the discarding of laws that have anticompetitive effects and have outlived their useful purpose. Commissioner Wesley Kinder of California, President of the National Association Insurance Commissioners, made the point at the June, 1980 NAIC meeting: "The fate of our system of regulation at the state level remains primarily in our control".[10]

IIAA POSITION ON COUNTERSIGNATURE LAWS

In 1972, the National Board of State Directors recognized that countersignature laws were outmoded. Accordingly, the National Board adopted a position favoring total abolition of countersignature laws.[11]

CONCLUSION

Retention of countersignature laws under the present regulatory climate on the state level cannot be justified. The states have adopted other laws and regulations to assure that the coverages purchased by the insurance consumers meet their legal requirements. Countersignature statutes serve no useful purpose, increase the cost of insurance, are protectionistic, and result in lessening competition. IIAA should increase its effort to seek their repeal before a federal solution is imposed.

The **Chairman**. But is it not rather surprising that all of the people you are referring to here support this concept?

Mr. **Rowland**. Senator, the support comes from the trade associations. The trade associations——

The **Chairman**. The support comes from hundreds of individual businessmen. I have been getting letters by the hundreds on this from all over the country, and they say: We cannot get the liability insurance that we need at a reasonable rate. We are not big enough to form an organization to carry our own insurance, and we cannot get it at a reasonable rate.

Mr. **Rowland**. Well, as a marketer of insurance, I wish I knew some of these folks, because I'll bet you I could find plans for many of them that would fit beautifully, that would produce dividends based on experience, and that would be underwritten and insured by commercial carriers that are regulated very well by the commissioners of the various States.

Mr. **Jordan**. I wonder if I could make a point?

Senator, I think you are abolutely right. There still are small manufacturers and distributors who have product liability affordability problems. The marketplace is not perfect by any stretch of the imagination, and we are not up here to state that it is, but it is adaptive, it is changing, and it is competitive.

The staff and the committee must recognize that we started off with a proposal on the one hand which granted very broad but vague regulatory authority to the Secretary of Commerce. It was just unreal the amount of regulatory—control has envisioned. The Secretary could take almost any action he wanted to, in furtherance of the act.

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[9] Department of Commerce, "Product Liability Risk Retention Act of 1979, Statement of Purpose and Need", Tab A, Attachment p. 3.

[10] National Association of Insurance Commissioners, News Release dated June 16, 1980.

[11] See pp. 3-5 Minutes of the January 1972 Meeting of the National Board of State Directors.

Then that was changed by the House and it was tightened up to some extent. Now we have a third proposal of a diametrically opposite nature, where there is no Federal bureaucracy—which is fine; but it goes on to cut out, most regulatory controls at the State level leaving those members of the "Shifting Sands Mutual," without protection or the administrative machinery to gain equity and redress.

Mr. Mack says, "Who is going to be hurt?" I will tell you who is going to be hurt: The people who buy the policies are gong to be hurt; the agents who sell the policies could be hurt; along with claimants and the public at large. Everyone can be hurt if this Shifting Sands Mutual is allowed to function in an improper fashion.

The Chairman. Well, let me ask you both a question. Here is an excerpt from the Alabama Insurance Code:

> All property, surety, and casualty insurers doing business in this state shall execute all contracts upon property or risks in this state through a licensed resident agent of the insurer who shall execute or countersign all such contracts.

Now how many State law provisions do you have like that?

Mr. Rowland. There are quite a few, Senator. I probably personally hold about 15 nonresident licenses in States that we do business in because of customers that we have in Racine that have locations in these States. It in a sense is a sham.

I can sign up for a nonresident license. I can pay a fee. The State of Wisconsin certifies to the State of Alabama, or wherever it might be, that I am a licensed agent, I am in good standing, and I think that to that extent that is not a bad regulation. At least they check on my trustworthiness back home.

I get a license by the payment of a fee, which is a reciprocal arrangement with the State of Wisconsin. The policy, changes are, is signed by the local company manager in the State of Alabama, and no countersignature fee is paid. It is purely a matter of form. It does not affect the availability of insurance in the State of Alabama to my client in Racine, Wis. And I write insurance, as I say, in at least 15 States and have these nonresident licenses, and there are no impediments—with the exception of two or three States that still have—where I must share some commission with the licensed resident agent. But that is something that we abhor, and we are trying to work that out. But it does not impede my customer from getting insurance in that State.

The Chairman. Well, suppose you wanted to sell insurance to a group of farm machinery dealers in your State and they wanted a group policy, and they operated in four or five surrounding States. Now is it your view that an agent from each of those States would be necessary? Or should one agent acting for the group negotiate the deal and write the policy?

Mr. Rowland. My contention is that that is entirely possible that I would, as an agent if I wrote that business, would have to have a license in those five States. But I tell you, it is not that hard to get. And I could have it countersigned in that State very easily and it would not impede in any way, shape, or form——

The Chairman. How do you have it countersigned? Do you have to have an arrangement with an agent there so that you pay him a part of the commission?

Mr. **Rowland**. Most of the times the company managers, if I write it with the XYZ insurance company, he is a licensed agent in the State of wherever, he signs the thing and sends it back to me, and that is a licensed agent signing the policy.

The **Chairman**. And does it involve any splitting of the commission or anything of that sort?

Mr. **Rowland**. As I said, in about two or three States that I am aware of, there must be some commission split. But to me, that is a problem that we are working on. You know, all States are not perfect, let's face it; but it does not impede—my customer does not suffer because of it, and I think that is the critical issue.

Mr. **Jordan**. Senator, to some extent it depends on if the individual is buying the policy and making his transaction in that State. That is if the business of insurance is being conducted in that State. I understand that the individual can go outside that State and purchase a policy, and he does not automatically have to go through countersignature in all cases.

Mr. **Rowland**. Most of the time, the flow of business and commerce works pretty well. And as I say, we represent dozens of clients who have locations outside the State of Wisconsin, and we insure those freely and are able to place business without any impediment for the customer himself. It may be a little paperwork on our part, but so what? That's our job.

The **Chairman**. Well, it bothers me in this instance. We have been in it for some time now, and as you say we have gone almost full circle. Because we had the various proposals that the Department sent up, and then the House proposal, and then this one here now that we have tried to develop.

But I have been very impressed by the small business people throughout the country that have contacted us and said: Our needs are not adequately being met, and we believe that something along this line is the best way to do it.

As I told you, Senator Nelson, the chairman of the Small Business Committee, saw me last night and he said: I think you have hit on something that I believe is a reasonable solution to a problem that is not met and needs solving, and he said, "I'd like to be put on as a cosponsor."

Mr. **Rowland**. Senator, I don't want to sound like we are stonewalling this thing. I really sincerely believe that this is probably a good, viable alternative to use. It's a good band-aid if the cut needs a band-aid. I just have a feeling that by opening the floodgates here, which you in effect have done by nonregulation, there is a regulatory vacuum that is created. And it just occurs to us that in that regulatory vacuum people are going to get hurt.

The business of insurance has evolved over a long, long period of time, and imperfect a system though it may be, it has basically been, at least in my State, a very competitive thing and the customer over the long haul has been very well served by it. Granted, the products liability crisis was a terrible situation. I cried, I laughed, you know with clients, because of the situations that we went through; but the fact remains that we got through it, and we are anxious to help our clients.

I think the real thing is Professor Schwartz tort reform. That has got to come, and that has got to be worked on very hard. I can solve Jim Mack's problems. Let's get the workplace accident situation solved. That will take care of the machine tool builders. They are not consumer oriented.

But we seem to think this is a panacea, and I tell you it is not.

The CHAIRMAN. You know we cannot reform the tort laws of every State in this country here, but we can try to help these poor business people out here that are trying to get insurance.

Now you, Mr. Jordan, mentioned that we ought to be able to do this and make some of these reforms, but some of these reforms proposals have been around for 10 years and there has not been much success.

Mr. JORDAN. Well, Senator, I think on that point I would not argue with that. Jim Mack brought up the fact that there was a resolution back in 1971 and the NAIC has yet to act on the thing on fictitious group filing. A couple of points on that.

First of all, you can form an insurance group without having to jump through the hoops of fictitious group filings. It is really kind of a redundant law. Nobody pays any attention to it. There are a thousand ways around it. It does not make any sense for it to still remain on the books. We do not support it.

We are actively opposed to State countersignature. I think the important thing is that your committee, doing what you are doing, is putting pressure on the States to act. Now they have a number of studies going; they are doing the best that they can.

I know that the Texas Insurance Department right now is holding hearings today, this very day, on self-insurance and that is why they couldn't be here. It's not because they weren't interested; they had prior commitments on hearings of their own.

I think the pressure that you are providing is very constructive, and I am hopeful that there will be an improved dialog between the States and the Federal people in this area to develop a solution. It cannot be done in a vacuum. In the past these proposals tend to be put together in a vacuum without adequate discussion with the States to find out what in fact is feasible and what is going on.

Mr. ROWLAND. Senator, I think the other supposition has been made that the insurance commissions in the various States are impediments to the kinds of innovation and things that should take place. I can tell you that at least from our standpoint, the insurance commissoner was extremely concerned over the product liability crisis and did everything within his power at that time to see that we set up our MAP program, and to see that we tried to tide the situation over.

I think the commissioners in the other States are equally concerned. It is just that it is a situation which I think we are going to have to address, and we have the luxury of addressing it now in a period of relative calm. I think we should move ahead. I am not a stonewaller. I think a model law could well be provided that would enable risk retention groups, or whatever you want to call them—because to me it is still a formation of insurance companies, so a rose by any other name is still a rose; it is still an insurance company formation. Fine. But let us work that through in this period of relative calm so that we come up with a sensible solution that will have the regulatory safeguards that the public expects.

The **Chairman**. Senator Packwood?

Senator **Packwood**. Why don't you go to Senator Schmitt.

The **Chairman**. Senator Schmitt?

Senator **Packwood**. These young kids around here want to upset the system and ask questions first.

Senator **Schmitt**. Mr. Rowland, we like to get educated. There is something I want to get straight in my mind. What is the difference between an agent and a broker?

Mr. **Rowland**. There is very little difference in the way we operate between an agent—in my case, I consider myself, I have an agent contract with 25 companies, but I consider myself a broker to my customer because I truly represent him. You know, sure, I have this basket of facilities to use, but I can take my client into the surplus lines market, I have a surplus line license; I can go to London; I can go to any number of sources for supplying his needs.

So to that extent, if you look at the contractual relationship, it is kind of a mixed bag.

Senator **Schmitt**. So as long as you are an agent for more than one company, as you face the company you are an agent; as you face your client, you are a broker? Is that correct?

Mr. **Rowland**. I think that is pretty accurate. I have the authority to bind my companies that I have contracts with. I don't have authority to bind other companies that I don't have contracts with. To that extent, I have an agency relationship. I am an agent to the principal.

But really, the way we operate is that our primary concern is to the client we serve, because he is the guy that pays the freight.

Mr. **Jordan**. The broker here has much more access to the insurance marketplace than does the agent. I think that is the key distinction.

Senator **Schmitt**. Well, what he is telling me is—I am trying to think in very simple terms when it comes to insurance—and if you will allow me to be simplistic, in that where there is a multiagency agent, as he looks at his company he is an agent; as he looks at his clients in trying to serve their needs efficiently and effectively, he is a broker. He is trying to find the best one of his agencies that he represents that will serve that client's needs.

Mr. **Rowland**. That is to me a very accurate description of how we operate; yes.

Senator **Schmitt**. Now I presume there are some single-agency agents? Right!

Mr. **Rowland**. There are.

Senator **Schmitt**. What would you say, in your personal experience, is the proportion of product liability policies that you write for businesses versus other types of policies? Is it a small, medium, or large proportion of your business?

Mr. **Rowland**. It certainly got to be back in the time when the prices went through the ceiling, it got to be a very substantial part of our business.

You see, the historic problem of product liability was that it was an adjunct to a basic liability contract; it wasn't separable. It didn't stand on its own. And it was a give-away program. For many years we kind of threw it in. A guy with a manufacturing operation would pay for his general liability, and that might include his autos and his premises liability, say as an example, $5,000, and for another, $1,000 or $500 he would get product liability. It was based on sales, and a rate times sales, and it was a give-away.

Suddenly, as the society became more litigious and people figured out that they got hurt because the bottle top didn't come off right or something like that, and the lawsuits began to come in, the insurance industry was faced with a real dilemma. They had an ongoing flood of claims. They had no basic experience on product liability as defined separately from the general public liability area, and they panicked, and the prices went up to the sky, and they would look upon businesses who were in hazardous kinds of—I insured an air rifle manufacturer. Ah-hah. A hazardous business. How many guys would want to stand in line to take that risk?

And we had a real problem let's face it. And I think some things have settled back down now. This is a time of relative calm. It is a time of fierce competition. We are delivering policies today at half of the premium they were delivered for last year based on the reduction in products liability.

So I think now is the time to address this, but let's not do it in a hasty, panicky way. Let's come up with something that really can afford a good solution so that when the next downturn comes we can react in a good responsive manner and really help these guys out.

Senator **Schmitt**. Those who call themselves brokers, even though we have drawn a different kind of distinction here, have tended to support the staff draft, as I understand it, because "they seek to provide their clients with the best possible range of insurance coverage." They believe that the staff draft will provide "additions to the many options the brokers consider for their clients."

Well, is it your position either as an agent or a broker that this draft, if it became law, would not provide more options for your clients?

Mr. **Rowland**. I think it would provide an alternative. My big hangup with it is that the alternative is outside of any regulation in terms of the normal regulatory systems which protect ultimately the public. And that is what really many of our insurance commissioners are charged with. That is their responsibility, and that is what they do.

Senator **Schmitt**. But are not your clients generally saying: Hey, we would like to have that other alternative.

Mr. **Rowland**. Yes, and I would like to have it for them; I really would. I think this would be fine, and we would market it. Listen, you know, agents are wonderfully adept at marketing whatever products seem to be fitting for our client in whatever range. But I am not going to suggest—I've got errors and omissions insurancer on the line when I suggest joining or maybe even sponsoring a risks retention group that may be on shaky financial ground, and my clients think: Well, what the heck. It's a Wisconsin situation. The commissioner of Wisconsin is looking at this thing and I am going to join that group. I mean, after all, it has all the protections of the State behind it. And zappo, his group goes under, and maybe he is only liable for the assets he's got in the group, but where is his protection? What happens to the claimant that comes down the road and says: OK, I've got a judgment against you for $25,000 or $30,000 or $100,000, and there is no insurance company behind it?

That is the kind of caveat emptor I am afraid of. He thinks he's got the protection of the insurance commissioners of the State of Wisconsin, or whatever State, and he doesn't.

Senator **Schmitt**. Basically that is something that has to do with the differences between one State and another. Right? The ability to regulate insurance companies?

Mr. **Jordan**. There is another point here which we have not yet brought out adequately. That has to do with the state of domicile where a risk group might be formed. Let's say a California risk retention group has members spread out throughout the United States. The insurance commissioners of those other States are effectively precluded by this act from functioning directly to protect their own constituents who are manufacturers belonging to that California association.

At the same time, because of the extraterritoriality problem, the California insurance commissioner is very limited in what he can do to control and monitor insurance operations by that Risk Retention as it operates in other States.

There are recent citations concerning insurance company mergers and direct mail—dealing with extraterritoriality where States are effectively precluded from moving beyond their own border. The net results is that the FTC has stepped in, in the past, to say there has been a regulatory void there, and they ought to exercise jurisdiction. Now the FTC is precluded from such action unless directed by Congress.

So this is a real problem where you go outside the state of domicile. It is further exacerbated when you start bringing in foreign entities where there may be no regulation whatsoever, where premiums can be pulled back offshore. Commissioners don't even know whether there are any assets to pay claims, yet, the individual buying insurance protection is relying solely on his agent for protection and the agent is not in a good position to investigate the financial capability of this foreign Risk Retention Group nor is the average small businessman. He is buying an insurance policy, and he is going to be amazed if someone comes back to him and says: You're going to have to pay up a lot more money because we've got some bad claim experience.

Mr. **Rowland**. I think one thing, Senators, that this would do is it would help the unemployment situation, because no doubt there would have to be a new trade association formed, the National Association of Risk Retention Groups, which we have affectionately termed NARRG.

Senator **Schmitt**. Well, thank you, gentlemen.

Mr. Chairman, in listening to Mr. Jordan, I have realized there is another distinction which it was too bad that we could not have drawn earlier this year in our discussion with the Federal Trade Commission. Instead of being an agency in search of a mission, it's an agency in search of a void.

The **Chairman**. Senator Packwood?

Senator **Packwood**. Mr. Jordan, as you are aware, many groups justifiably identify their interest in the country's interest, and vice versa. Quite often, it may be in the country's interest, and quite often it may not; but I find it very hard for people in an industry to separate those two and often their testimony depends upon who stands to gain and who stands to lose.

In your association, how much product liability insurance do your members write?

Mr. JORDAN. I would have to make a guesstimate. I would say between 10 and 15 percent of what is being written nationally.

Senator PACKWOOD. And by far the greater portion of it then would be written by the stock companies?

Mr. JORDAN. Yes, I would believe that is true, Senator.

Senator PACKWOOD. What does your membership stand to lose if the draft is adopted?

Mr. JORDAN. You could look at that a number of different ways. We think there would be great dislocation in terms of State regulation.

Senator PACKWOOD. And how would your members stand to lose by that?

Mr. JORDAN. Stand to lose directly?

Senator PACKWOOD. Yes.

Mr. JORDAN. I would have to give that some thought.[1]

Senator PACKWOOD. I am coming right down to the meat and potatoes of it. I want to know if your association's membership is going to stand to lose financially by the passage of this bill—not is it good or bad legislation because it weakens or strengthens State regulation—do you members stand to lose by this bill?

Mr. JORDAN. That would depend on who uses it and how. Actually, our own association might even benefit. If you look at the history of the Alliance of American Insurers, we are primarily mutual insurance companies.

Senator PACKWOOD. I am aware of that.

Mr. JORDAN. We have lumbermen, we have pharmacists, druggists, you name it. They have each formed their own mutual insurance company. We even have a Churchmen's Mutual. These people formed their own insurance entities because there were problems in the insurance marketplace. There were availability/affordability problems.

So we are not against the formation of risk retention groups. I've made that point before, and I wanted to make it again. We are not against the formation of these groups.

What we are against is our concern of abrogating State regulation, creating a regulatory void, putting together a proposal that has not been fully thought out yet, blindly endorsed by some simply because it is a Federal proposal.

Here you have the proponents on the one hand supporting this bill while previously they support the diametrically opposite approach. It seems to me they could support claims on any proposal as long as it has the Federal stamp of approval on it to get something passed. And we think that if there is going to be something passed, it has to be something that is given proper consideration.

Senator PACKWOOD. Well, that switch of position is not unique in the annals of American politics.

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[1] A subsequent response was sent by Alliance to Senator Packwood on this question.

I have been amazed how many people have been opposed to Federal regulation that could switch their position when they thought it might be favorable to something they wanted to achieve. Suddenly, the philosophical opposition drifts away someplace.

But I understand that. I am not even going to argue for it or against it. I have come to expect it. But I am curious once more. You think your members will not stand to lose much by this; they might gain something, but it is not a big financial issue one way or the other with your membership?

Mr. **Jordan**. It would depend. We would not suffer great competitive loss but there are a lot of unknowns here. There has not been an impact analysis done on this bill. For example you are including comprehensive general liability. God knows what is going to happen in terms of all these various insurance coverages contained under that umbrella in terms of organizations who might opt for a risk retention alternative.

You could have an exodus of capital offshore, which is directly opposed to the objectives sought by the Commerce Department. They want to keep capital in the United States. But if you assume that the locus of least resistance in terms of regulatory control and jurisdiction is offshore somewhere, you are going to find groups going offshore.

No organization likes to be regulated per se because regulation means loss of control and it costs money.

The important thing is, the regulation needs to be in balance. It has to protect not just one set of rights and interests and objectives, but a whole set of competing objectives. That is the point we are trying to bring out in our statement.

Senator **Packwood**. Well, I understand that. The purpose of the legislation is not to protect you, or Crum and Foster, or any other company from the Federal Government or from the States. The purpose is to try and solve a problem which many businesses justifiably say they have, and they do have, obviously.

I agree with the chairman. Enough of them have called me up. These are not chronic cranks and complainers. They are having trouble, for some reason, getting the insurance they want. They are not calling up about Federal regulation or lack of it; they just say: Look, here is my problem.

Mr. **Jordan**. We would be for changes in State regulation. People don't seem to realize that. They think the alliance is only interested in stonewalling this bill. If there are impediments that are true impediments where the costs outweigh the benefits, we would be for changing them. But we would be for changing them at the State level.

We do not like the idea of Federal preemption, but we would even live with a Federal preemption on State countersignature and fictitious group filing, as we said, that was in title II of the prior bill.

Senator **Packwood**. Let me ask you another question, because this technical panel is going to follow you.

In your statement you say: "The draft undercuts the application of existing State regulation in the operation of risk retention groups to such an extent that their financial solvency and ability to pay claims would be seriously compromised."

Give me the basis for that statement. The reason I want the basis is that if there is a good basis for it, I want the technical group that testifies next to address your concerns.

Mr. JORDAN. Well, the way I understand the proposal as drafted at the present time—I brought a scenario out in my statement.

You could develop a risk retention group offshore. Anyone could. If you were devious, you could develop a risk retention group that really had no assets. You could print your own insurance policies——

Senator PACKWOOD. Of course you could do that now.

Mr. JORDAN. No, because if you try and go back in now and sell those policies in the United States, you are going to have an insurance commissioner breathing down your neck saying: Wait a minute. I want to see those assets. I want an audited financial statement. I want to make sure you meet certain requirements before you sell your policies in my State.

You would not have this under the Risk Retention Act. As an insurance commissioner you would not be able to fulfill that function of protecting your constituents, which you are either appointed or elected to do.

Senator PACKWOOD. All right, now, I want those who are going to testify next to hear his answer and address your comments to that on this subject. Go ahead. Or was that the end?

Mr. JORDAN. That was basically what I wanted to say.

Senator PACKWOOD. Then let me ask Mr. Rowland a couple of questions.

Mr. Rowland, if each of the States wanted to adopt the provisions of the staff draft, what do you think the position of your association would be on such legislation at the State level?

Mr. ROWLAND. I would personally have to favor it and urge that my association does the same. It is a little hard to speak for—I stand up here for 126,000 people, but until the State Board of National Directors tells me that that is policy—but I certainly would urge that on our association, and I feel that although there might be some controversy—but let's face it. You have a divergence of opinion on this thing, and——

Senator PACKWOOD. Your State association might even split from State to State on it.

Mr. ROWLAND. Conceivably.

Senator PACKWOOD. I have no other questions, Mr. Chairman.

The CHAIRMAN. I wonder if we could have Mr. Cheek and Mr. Larsen come up and join you gentlemen, in case some of my colleagues may have some questions for them; or they may want to add something to what we have heard here already.

Mr. ROWLAND. Senator, would it be possible for me to make just one last point?

The CHAIRMAN. Certainly.

Mr. ROWLAND. I got questioned before I finished, and it really is a quick one.

The CHAIRMAN. Sure.

Mr. ROWLAND. I think that one of the things that might come out would be the chartering State would have regulatory control over the risk retention group that is being formed. And that gives us a little pause for concern because of the extraterritorial jurisdiction that could be exercised by that State in an attempt to regulate that particular aspect of the group.

It worries us because the Supreme Court has spoken on this. It has to do basically with the—well, let me just read it:

In the same case, the Supreme Court buttressed this argument by referring to the legislative history of the McKaren-Ferguson Act and noting that:

> One of the major arguments advanced by proponents of leaving regulation to the States was that the States were in close proximity to the people affected by the insurance business and therefore were in a better position to regulate that business than the Federal Government. Such a purpose would hardly be served by delegating to any one State sole legislative and administrative control of the practices of an insurance business affecting the residents of every State in the Union.

Senator **Packwood**. What are you quoting from? What are you quoting from right there?

Mr. **Rowland**. This is the Supreme Court, *Federal Trade Commission* v. *Travelers Health Association*, 362 U.S. 293.

Senator **Packwood**. What year is that?

Mr. **Rowland**. I don't know. It is fairly recent. But it is in the testimony.

Senator **Packwood**. Thank you.

Mr. **Rowland**. I just think that it is a point that needs to be made, that one jurisdiction, whether it be a U.S. jurisdiction or a foreign jurisdiction, is going to have a difficult time in extraterritorially regulating the business of insurance, which has been historically left to the States—and I think really basically done pretty well as far as the consumer is concerned on balance, not 100 percent perfect, but what is.

The **Chairman**. Mr. Cheek, there has been concern expressed that under the bill manufacturers might establish dangerously underfunded captives.

Now, as I understand it, your company and others furnish management service to captives. Based on that experience, do you think that is a valid concern?

STATEMENT OF LESLIE CHEEK, VICE PRESIDENT, FEDERAL AFFAIRS, CRUM & FORSTER INSURANCE COMPANIES, WASHINGTON, D.C.

Mr. **Cheek**. No, we don't, Senator.

The major reason that captives turn to us and other companies that have captive management subsidiaries, is to take advantage of our expertise on technical insurance matters.

One of the most important of those technical matters of course is the amount of capital and surplus that is appropriate to the nature and the amount of the captive's liability exposure.

We and other companies with captive management subsidiaries have a strong self-interest in seeing to it that our customers succeed; because if they fail, we not only lose a valuable source of business, but equally important, we lose our reputation as a reliable source of insurance expertise.

We for one—and I am sure this would be true of any other company with a captive management subsidiary—would insist, the captive's wishes notwithstanding, that it be adequately funded for its risk exposure. We think it is highly unlikely that any captive that turns to the insurance business for help will be underfunded.

The CHAIRMAN. It certainly wouldn't be in the best interest of its members, because each of their customers have to be a member of that association.

Mr. CHEEK. That is correct. And if they do underfund it, the members of that captive become ultimately liable for that exposure out of their own assets.

The CHAIRMAN. Mr. Jordan?

Mr. JORDAN. I think what Mr. Cheek says is absolutely correct. But we were not making that point. The point just made is that when you have an insurance entity, such as a reinsurer, whose own money is on the line, they want to make sure that the captive, risk group, whatever it happens to be, is properly set up. Because they eventually may have to pay the freight for the loss exposures it assumes.

What we are talking about is not where you have a major broker necessarily, or a commercial insurer standing behind and involved in some way in the insurance transaction, but where you have a risk retention group set up completely lacking the assistance of a knowledgeable insurer or broker.

Who is to stop somebody from going out and forming their own insurance company right now in any foreign location—which you could do under the act—and coming back and selling insurance policies where you don't have a Crumb and Forster behind you?

Mr. CHEEK. Could I respond to that?

The CHAIRMAN. Certainly.

Mr. CHEEK. Even if Mr. Jordan's hypothetical is correct, any captive is going to require either some form of excess or umbrella coverage over the exposure it assumes for itself, and those umbrella and excess carriers will in turn require some reinsurance.

The CHAIRMAN. In other words, they will lay off part of the risk to some other company or companies.

Mr. CHEEK. That is correct. If you think of it as a chain and take the aphorism that a chain is only as strong as its weakest link, the reinsurer is going to want to make bloody sure that its premium is adequate for its exposure. Similarly, the excess or umbrella carrier underneath him is going to want an adequate premium for its exposure, and will be very, very interested in whether the underlying captive is adequately funded for the exposure that it agrees to assume. So I think the discipline of the marketplace here would assure, even if there were no regulation of the underlying capital and surplus and what have you, that these Godzilla-like creatures that some of the testimony suggests will be unleashed on the public won't be created.

Mr. JORDAN. Maybe if I can respond just once more. What Mr. Cheek says would be true but only if the risk retention group is formed in Bermuda or someplace where you have an effective regulatory framework already in place.

But even Bermuda has tightened up its own regulations, and some captives there have been going elsewhere because they don't want to meet Bermuda's requirements. Some of them have been going to the Cayman Islands and elsewhere. Some captives are being forced to try other places where there are no requirements for capital, surplus, excess insurance, or reinsurance, or anything else. All you have to do is pay a fee and you incorporate and you are home free. There may be no market entities who automatically provide stability and assistance in such instances.

The CHAIRMAN. Mr. Larsen, what is your position in the insurance business?

STATEMENT OF ROBERT LARSEN, PRESIDENT, INSURANCE ADMINISTRATION CENTER, INC., PARK RIDGE, ILL.

Mr. LARSEN. Mr. Chairman, I am an insurance agent and broker. I insure some 1,000 small corporations. I act as an adviser to trade associations representing 4,000 to 5,000 other small businesses. I write and speak extensively on the subject of product liability and I have addressed the subject at more than 500 national conventions.

Over the past decade I have had occasion to listen to the complaints and the problems and the expressions of great concern from small businesses across the United States—and definitely including the State of Wisconsin.

We have seen cancellations of association-sponsored programs for reasons other than excessive loss. We have seen situations where the major insurance brokers of the world were unable to place the product liability and the excess liability coverages for small and medium-sized businesses. In one case I recall the instance where the largest insurance broker in the world went to 31 different insurance markets and was turned down in all of them, during the 1974, 1975, and 1976 downturn of the insurance cycle.

It seems to me that the situation has been characterized as a bandaid for a problem that really doesn't exist. I represent the drug wholesalers, the distributors of Band-Aids, and they had to form their own insurance company in Bermuda.

The situation that we presently face has to be viewed in light of the fact that through perhaps the last four decades the casualty insurance industry has been on a roller coaster pattern of earnings and losses running 3 or 4 years in an up-cycle, and 3 or 4 years in the down, and the very essence of insurance being predictability, being able as a small businessman to have some expectation of what it will cost you to insure the appropriate risks of running your business, when they are caught in the down cycles which seem to be getting deeper, and find themselves facing 1,000 percent rate increases as many of our clients were, finding many of them having their insurance coverage canceled, having in some instances been with one insurance company for 10, 12, 14, 18 years without ever sustaining a single loss, and then having that insurance company cancel their policy because the capacity to insure was constricted worldwide or in the United States or in that particular company and they thought they would not like to involve themselves in what they regarded as a rather unpredictable and potentially catastrophic loss area, that of product liability, then we see the withdrawals that we saw in medical malpractice, in long-haul truck, in excess liability, and the most recent one of product liability.

The business community, the business leaders that I have talked with, the small businessmen that I've chatted with personally over the many years that I have been associated with these various associations, they say they want an alternative.

They want an insurance mechanism to be in place to respond to the next down cycle—perhaps building in some honesty or some predictability into the domestic insurance marketplace with the risk transfer mechanism. They want to be able to say that if they find that the price of product liability insurance in their opinion is not risk-related but rather just responding to the cash flow manipulations of the domestic insurance marketplace, then they want to be able to say: Fine. You play the game your way in the free enterprise system, and we would like to play it ours.

We would like to offer that alternative. That is why many of the insurance companies in the alliance came into being. They found the insurance marketplace unresponsive.

Most of those major companies were formed 20, 30, 40, and in many cases 50 years ago when it was a lot easier and State regulation was not the octopus that it is today. We are just simply saying that we would like a risk transfer mechanism that would have a built-in memory.

That if we go 10 years loss-free and have 1 bad year, we want to be able to have developed the loss reserves and the stability of pricing—because we know there will be down periods and shock losses that occur from time to time. But unlike the medical malpractice situation which is interstate in nature, the product liability problem is intrastate.

We are facing a product, and a distribution of that product in the 50 States, so that manufacturers, distributors, and retailers can find their product in any jurisdiction, and it is the jurisdiction in which the occurrence takes place, in which the injury takes place whose law would apply in a product liability case—contrasting this with the case of a physician who performs a particular operation or makes a prescription that proves incorrect. They know what State law will apply in that instance.

In product liability, one of our wholesaler clients could distribute a product in Chicago that could find its way into the California markets and be subject to the laws of that State.

So we have looked very carefully. We have debated this subject intensively, really, since 1968. As we watched the problem develop, our initial reaction was that that was a tort liability problem—the strict liability doctrine which had its genesis in California and seemed to work eastward. We thought that was the essence of the problem.

The more we got involved with it, the more we tried to approach the domestic insurance marketplace asking to problem-solve together, the more we found them unresponsive to that approach of ours, the more we have now come to the conclusion that the insurance mechanism as it exists in the United States is itself flawed.

We think that the Risk Retention Act as it is proposed in the Senate draft will make them all a little bit more responsive to the needs of small- and medium-sized business.

The CHAIRMAN. As a matter of fact, it would probably make the insurance industry a little more competitive in that area, would it not?

Mr. LARSEN. I don't think there is any question about that. I think they sense that, and probably the most thoughtful and legitimate resistance on the part of the insurance industry is in their own self-interests. Some of them have characterized the act as being "other than in their self-interest," and I would suspect that is the case.

If I was in business, I would like a monopoly if I could get it. I wouldn't like it if someone else had it.

The CHAIRMAN. Is it currently necessary for each of the 50 States to check the product liability policy forms? Or is it customary to use a standard policy form?

Mr. LARSEN. In my experience, the vast majority of product liability and completed operations insurance is written on a standard ISO, Insurance Services Office, form.

There are many manuscript policies for exotic risks, particularly those that might be placed in the London market or through some specialty excess and surplus lines carrier they will create a policy. When you are into those Lloyd's policies, or in the case of the general excess and surplus lines market, those policies are not filed and approved in the majority of jurisdictions.

The CHAIRMAN. Senator Packwood?

Senator PACKWOOD. Just one question, Mr. Chairman.

Mr. Larsen, is the Insurance Administration Center your personal business?

Mr. LARSEN. Yes, sir.

Senator PACKWOOD. I wasn't sure if you were representing an association I had never heard of or not.

Mr. LARSEN. No.

Senator PACKWOOD. Thank you. I have no questions.

The CHAIRMAN. Thank you very much, gentlemen. We appreciate your being here with us today. That concludes the hearings for this morning.

[Whereupon, at 11:31 a.m., the hearing was adjourned.]

[The following was received for the record:]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

MACHINERY AND ALLIED PRODUCTS INSTITUTE,
Washington, D.C., April 11, 1980.

Hon. HOWARD W. CANNON,
Chairman, Senate Committee on Commerce, Science, and Transportation, Washington, D.C.

DEAR SENATOR CANNON: We note by your release of April 2, 1980 that the Senate Committee on Commerce, Science, and Transportation will hold a public hearing on April 22 on S. 1789, the Product Liability Risk Retention Act of 1980.

Products liability is a subject in which the Institute has long been deeply interested and in which we believe we have a certain degree of expertise. Under normal circumstances, we would have respectfully requested an opportunity to appear and testify in these public hearings. Unfortunately, both the undersignaed and MAPI's Senior Vice President, Charles I. Derr, will be out of the city on business travel on April 22.

It is our understanding that S. 1789 is a companion bill to H.R. 5258, which was considered by the Consumer Protection Subcommittee of the House Interstate and Foreign Commerce Committee in its hearings held last fall. As you know, of course, a number of amendments to that original bill were adopted in the course of full Committee and House action. The amended version of that bill, H.R. 6152, has now been adopted by the House.

Most of the things that we said in House hearings concerning the general thrust of the risk retention proposal are still applicable. Accordingly, we enclose a copy of our written statement to the House Consumer Subcommittee.

The Institute endorses the concept of the Risk Retention Act and generally approves those amendments adopted by the House.

Finally, we ask that this letter and its attachment[1] be included in the printed record of hearings on S. 1789.

Respectfully,

CHARLES W. STEWART, *President.*

NATIONAL ASSOCIATION OF CASUALTY & SURETY AGENTS,
GOVERNMENT AFFAIRS OFFICE,
Washington, D.C., April 22, 1980.

Hon. HOWARD W. CANNON,
Chairman, Senate Commerce Committee, Washington, D.C.

DEAR SENATOR CANNON: On behalf of the National Association of Casualty and Surety Agents (NACSA), an association representing 321 of the leading property/casualty commercial insurance agents and brokers, I would like to express NACSA's unequivocal opposition to the enactment of the "Product Liability Risk Retention Act," currently under consideration by your Committee.

Mr. Chairman, as President of NACSA I consider it my duty to communicate NACSA's concern and alarm over this unwarranted attempt by the Congress to further intrude into the business of insurance. This legislation will diminish the authority of the states by repealing state laws and denigrate the authority of the state insurance legislators and regulators. The unfortunate aspect of this bill is that it ignores the United States-based group insurance mechanisms already available and working at the state levels; such as state chartered captives, reciprocals, mutuals, stock companies, and safety groups. Colorado and Tennessee laws both permit the formation of group captive insurance companies. Fifty-three reciprocals operate under and are regulated by state insurance laws. There is no doubt that a Federal chartering mechanism would be created by the legislation which would expand the role of the role of the Federal governments into the regulation of the business of insurance.

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[1] See House printed hearings.

On March 10, 1980, the House of Representatives was blind to the weaknesses of H.R. 6152 and the real consequences of its final enactment. These Representatives failed to recognize the serious nature of this legislation's preemption of existing state protection of insurance claimants, a failure to provide guarantee funds to secure the payment of consumer claims, and a lack of awareness of the potential financial dangers this mechanism could bring about in light of Federal inexperience in managing mechanisms. This legislation will not solve the problem at hand. It will actually worsen it if adverse selection results. If anything is to solve any cost problems for product liability, state tort reform will, not Federal insurance mechanisms that do not address the real problems and ignore available resources already operating at the state level.

I would appreciate, Mr. Chairman, your incorporating my letter into the record of the Senate Commerce Committee on the "Product Liability Risk Retention Act." NACSA's members hope you will take their views into serious consideration and that you will oppose enactment of this Act.

Respectfully yours,

PHILIP L. COCHRAN, *President.*

CRAIG SUPPLY CO., INC.,
Durham, N.H., April 28, 1980.

Hon. HOWARD W. CANNON,
Washington, D.C.

DEAR SENATOR CANNON: It is my understanding that additional testimony can be added to your April 22, 1980, Hearing on the Risk Retention Act, S. 1789. Please include this letter.

The problem of product liability has been of great concern to our industry for nearly five years. During recent years, the number of cases and the size of the awards have increased substantially. This is of particular concern to small business who could not self-insure as a corporate giant can, may not be able to buy insurance at any price, or can only at exorbitant costs.

I have served on the Board of Directors of LACATA; Laundry & Cleaners Allied Trade Association, and NALCC; National Automatic Laundry & Cleaning Council during this time. The N.A.W. has sought to bring reasonableness to this area of the law, both at the State and Federal level. No responsible businessman wishes to escape liability for injury he has caused, but the present situation is unreasonable, punitive, and may well result in the bankruptcies of many innocent smaller business with corresponding loss of jobs. The attorney fees for defense alone are high.

Our present suit, which should come to trial in June, is not unusual. Two years ago, two women injured one hand (on separate occasions) in a flatwork ironer. These suits total $750,000. We acted as a broker in the sale of this piece of equipment in 1958, receiving $600 finders fee. At that point, the machine was remanufactured by the company we bought it from. It was originally manufactured about 1930. Our Company did not deliver, install, or service the machine originally and has never had anything to do with it since.

Now, everyone who had anything to do with the situation is being sued, and there is a good chance that our insurance will have to pay the claims. This seems completely unjust to me. Why wasn't this handled under Workman's Compensation Insurance? I do not see liability on our part and cannot see why we should have to pay excessive legal fees to protect our interests.

In March the House passed the Bill 332 to 17. I urge you to move this Bill out of Committee as soon as possible and strongly urge your committee to support and pass this bill so the Risk Retention Act can become law.

Small businessmen throughout the country will thank you.

Than you for his opportunity to be heard.

Sincerely,

R. B. CRAIG, Jr., *President.*

THE SECRETARY OF COMMERCE,
Washington, D.C., May 5, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I wanted to express my personal thanks to you for so promptly holding a hearing on the Product Liability Risk Retention Act. I hope that despite the Committee's busy schedule, it will act favorably on the Risk Retention Act this Session.

Product liability problems and their associated insurance costs continue to plague the American business community—especially with respect to smaller and medium sized businesses. While some witnesses before your Committee indicated that the problem is caused solely by increases in the number of and size of product liability claims, every objective study has shown that insurance ratemaking practices in the area of product liability have been overly subjective. More importantly, it has not been demonstrated that any increases in the number and size of claims justified the huge product liability rate and premium increases that the American business community has experienced in recent years.

Through the injection of competition in the marketplace, the Risk Retention Act will provide assurance to all groups that product liability rates and provide assurance to all groups that product liability rates and premiums will be based on the best available actuarial assessments of actual product risk. Its passage will also add additional capacity to the insurance industry and ensure that any cost savings which may be wrought by tort reform will flow to the purchasers of product liability insurance.

I respectfully request that this letter be made part of the record of your hearings.

Sincerely,

PHILIP W. KLUTZNICK,
Secretary of Commerce.

THE SECRETARY OF COMMERCE,
Washington D.C., June 16, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As Acting Secretary Hodges indicated in his letter of May 27, we followed your suggestion and convened a meeting at Commerce with representatives of the insurance industry to discuss the effect of state insurance laws and regulations on the ability of manufacturers and product sellers to form risk retention groups. We have now had the opportunity to review the transcript from this meeting and we wish to highlight the following key findings:

> Existing state insurance laws and regulators prevent, as a practical matter, the creation of risk retention groups as contemplated by the pending Product Liability Risk Retention legislation.
>
> Bermuda captive insurance companies are not a proper vehicle for small business trade associations and other self-insurance groups.
>
> Federal legislation appears necessary in order to facilitate the formation of self-insurance groups.

For your information and the other Members of the Committee, I have enclosed a more detailed discussion of these findings and a summary of the meeting.

Again, we have valued your estimated interest in the Risk Retention Act and look forward to favorable action on the proposal by your Committee.

Sincerely,

PHILIP M. KLUTZNICK,
Secretary of Commerce.

Enclosure.

SUMMARY OF THE PRODUCT LIABILITY RISK RETENTION ACT FORUM

In response to a request from Senator Howard Cannon, Chairman, and Senator Bob Packwood, Ranking Minority Member, of the Senate Committee on Commerce, Science, and Transportation, the Secretary of Commerce asked the Department's Product Liability Task Force to convene a meeting with state insurance regulators and experts in the insurance and risk management field, to resolve the issue of whether Federal legislation is necessary to facilitate product sellers forming self insurance groups and purchasing commercial product liability insurance on a group basis. The form was held on May 21, 1980 from 1:00 PM to 5:00 PM, and was attended by:

Lyndon Olson, Member, Texas Board of Insurance;
Joseph Bridges, Warren and Sommer Insurance Brokers;
Curt Urbanski, President, American Insurance Marketing Corporation;
Leyton Hunter, Consultant, Crum & Forster;
Howard Weber, Risk Manager, 3M Corporation;
Robert Larsen, Insurance Administration Center;
Harry House, President, Verlan, Ltd.;
Louis Marchese, Counsel, National Association of Wholesalers-Distributors;
William Dennis, Research Director, National Federation of Independent Businesses; and
James Mack, Public Affairs Director, National Machine Tool Builders Association.

This paper summarizes the results of that forum. Section I presents generally our findings and conclusions. Section II summarizes and highlights key arguments presented by the witnesses who believe that the Risk Retention Act is unnecessary, and those who believe that it is needed. Section II supports the findings and conclusions.

SECTION 1—FINDINGS AND CONCLUSIONS

Finding 1

There are alternative marketing mechanisms to the ordinary purchase of commercial insurance. These mechanisms include: Domestic captives, safety groups, mass marketing groups, groups rated on member's experience, mutual, stock or reciprocal companies formed under state law.

Nevertheless, each of these mechanisms has serious shortcomings. These include:

Reliance on a commercial underwriter for coverage;

Being subject to market swings and cycles;

Reliance on favorable interpretation of state laws and regulations. These interpretations can change when commissioners change;

Some operate through the circumvention of state laws;

Domestic captives must rely on fronting arrangements to operate in other states unless the captive itself can qualify as an insurer. If there is a downswing in the market the front may no longer be available. It is clear that if a front remains available, it will increase costs charged to the domestic captive.

Finding 2

Captives can be established in foreign countries.

They are usually established by larger companies with other overseas operations. Some small and medium sized companies have benefited from captives formed by trade associations.

Regulation of overseas captives is under review by foreign governments and may be subject to change in the future.

Sound public policy dictates that a viable domestic alternative be available for small and medium sized companies.

Finding 3

The insurance industry is subject to sharp cyclical market swings. Recent experience has caused insureds to seek insulation from these cycles. There is currently no domestic alternative market mechanism available that permits groups to control losses and provide independent underwriting of risks. Current alternatives do not permit the stability and predictability that is needed for companies to make a long term commitment to self insurance.

Finding 4

Group programs have been cancelled by commercial insurers on numerous occasions especially at times when it is difficult to obtain new coverage in the commercial market. While there is apparent increased interest by insurers in providing mass marketed coverage today, it is questionable whether the coverage will remain available during the predicted downswing in the market during the next twelve to eighteen months.

Finding 5

Foreign captives formed by associations are a viable competitive influence on insurance written in the industry the captive serves. This suggests that if product sellers have the opportunity of forming risk retention groups, this will be a market force that will lead toward continued competitive pricing of rates and premiums. This competitive effect cannot be assured by current mass marketing techniques as a result of the continued reliance on commercial underwriting. Colorado and Tennessee captives cannot achieve this result due to their limited number and scope of membership.

Finding 6

Foreign captives formed by trade associations, and the few groups that have been formed by a major broker, develop rates based on the experience of the group members. Both are able to offer product liability insurance to their members at significantly reduced cost. This suggests that risk retention groups will be able to offer similar benefits and that the cost reduction will be far greater than the somewhat lower administrative costs that are anticipated.

SECTION II—KEY ARGUMENTS

During an extensive question and answer dialogue, the specific areas that were in conflict during the April 22 hearing were discussed and differing views were expressed.

Fronting

One means of easing the burden on companies who seek to self-insure is to set up a reinsurance unit in either Colorado or Bermuda and have a commercial insurer front for the organization. In a number of states, the fronting insurer can cede back 100 percent of the risk to the group reinsurer captive. As a practical matter, the group must use a front or be acceptable itself as either a surplus line carrier or a primary carrier.

The witnesses differed sharply as to what would happen to a fronting arrangement in a market downturn. Those representing product sellers indicated that the captive might have to fold up because the front declined to provide further coverage. Some said that the fronting organization might well continue to insure the group, although it might require a higher amount of capital to guard against the possibility that the captive might be unable to pay claims. (T. at 95). One witness indicated that fronting groups require as a minimum a payment of $60,000 annually. They also may require a substantial premium level. (T. at 97).

Solvency of risk retention

Some witnesses indicated that the Risk Retention Act might lead to insolvency on the part of some groups. Other witnesses observed that Colorado does not require its participants to be in a guaranty fund nor does Bermuda, and that the groups that are likely to use the Risk Retention Act may not have coverage at present. Therefore, Risk Retention Act coverage was better than "nothing." Finally, it was noted that the Department of Commerce has an obligation to review the groups prior to their obtaining a charter. A key part of this review is to assure that there is adequate capitalization of the group.

Colorado captives

It was indicated that some alleged impediments in Colorado law may not be as serious as they would appear in the statute. For example, the Colorado captives statute requires that the group show that it has serious "affordability" problems. One witness indicated that this requirement is not vigorously enforced. The statute also requires that the group have been in existence for a year prior to making an application, but the same witness indicated that there might be ways of getting around this requirement also. However, all witnesses agreed that the group must have a domicile in Colorado and must supply minimum capitalization requirements. It was noted that the Colorado commissioner had testified that the captives portion of his law would be enforced even more vigorously than the commercial portion. The Colorado group would require a fronting insurer in other states or be qualified to do business in other states.

Bermuda captives

Small business captives could be formed in Bermuda but they represent a very small percentage of the captives that are there. (T. 85). Bermuda captives would require a fronting insurer if they want to do business in other states (unless the group itself qualified as a primary or surplus lines insurer). It was indicated that the requirements for Bermuda captives were toughening up and that there could be no assurance that they would continue to be lenient in the future.

Cost of the Risk Retention Act program

There was some dispute as to how much the Risk Retention Act program would cost. One witness estimated that it might cost as much as $2,000,000, however, his figures on the number or size of staff were not the same as the Department of

Commerce's. The Congressional Budget Office indicated that it would cost $150,000 in start up costs for the Act to begin operation.

Audience reaction

The Chemical Manufacturers Association, the Material Handling Institute and Special Committee on Workplace Reform indicated that their respective groups support the Risk Retention Act. A representative of the Alliance of American Insurers indicated that Federal action in this area was not necessary. One individual indicated that he found the Colorado law useless because his groups' members were located in other states. A representative of the National Association of Manufacturers expressed concern that the attitude of some members of the insurance industry about the Risk Retention Act was creating a division in the business community between insurers and their customers.

Summary of prepared testimony

The witnesses divided into two distinct groups. Those who thought the Risk Retention Act was unnecessary and those who thought it would help resolve the product liability problem. The respective testimony is summarized below:

Witnesses who believed the Risk Retention Act was unnecessary

Mr. Lyndon Olson, a member of the Texas Board of Insurance indicated that his primary concern was that there was no guaranty fund under the Risk Retention Act. He also noted that there was no direct requirement for payments to be made in a timely manner. He also thought there was no need for Federal rule abolishing fictitious group laws. He believed that the NAIC could accomplish this goal through a general recommendation; however, it was noted that an NAIC committee had made that recommendation as long ago as 1971 and there had been very little state action in response to it.

Mr. Joe Bridges, of Warren & Sommer Insurance Brokers, indicated that the only practical difference between establishing a self insurance group under the Risk Retention Act versus under the Colorado or Tennessee captive laws was that the latter would require a fronting mechanism. A fronting mechanism is one where a captive in one state makes an agreement with a commercial insurer to lend its license to the captive. This enables the captive to do business in other states. Mr. Bridges indicated that the fronting company would make sure that all components of the self insurance program were correct, i.e., that it was adequately capitalized.

Mr. Bridges indicated that the market for product liability insurance was better now than it had been in 1976–77. At that time, the sharp escalation of rates was brought about because the insurance industry "was caught off guard." (T. at 23). He stated that "there was some overcharging of available coverages," but that this was caused by the insurance industry's "deliberate" action "to get management's attention that there was a product (liability) problem . . ."*Id.*

Mr. Curtis Urbanski, President of the American Insurance Marketing Corporation, echoed Mr. Bridges' view that captives could be readily formed under existing state law. He also noted that because trade associations were already in existence, they could avoid the fictitious group laws. He indicated that aside from fronting groups, brokerage houses might help put self insurance mechanisms together. As an example of this, he cited the National Association of Supply Distributors captive.

Mr. Leyton Hunter, a consultant to the firm of Crum & Forster Insurance Company, indicated that the product liability problem was caused by "judicial generosity," rather than any problem with the insurance mechanism. (T. at 33). He echoed the thoughts of Mr. Bridges and Mr. Urbanski in observing that if self insurance would be helpful, it could be done under existing state law.

He also opposed the Risk Retention Act because it did not provide an adequate substitute for state regulation. He also objected to the fact that it prohibited assessments and retroactive adjustments except on a pro rata basis. Finally, he thought that the Act was adequate because it provided too easy a means for withdrawal of participants.

Witnesses who believed the Risk Retention Act was necessary

Mr. Howard Weber, Risk Manager of 3M Corporation agreed that there were in existence "new and imaginative financing systems" to meet demands for insurance. Nevertheless, he found that existing systems have some serious weaknesses. First, he noted that these alternative systems lacked "long term stability." He observed that the Colorado system was quite dependent upon having a commissioner who was extremely flexible with respect to regulatory requirements. When that commissioner left office, the system could change. Moreover, he noted that the states with very heavy concentrations of home offices of major corporations did not have special captive laws. This created an inconvenience of having to move to Colorado.

He noted that the instability problem also could affect offshore captives. He asked, rhetorically "can we count on them in the long term when we are financing risks that have tails of 10, 20, and 30 years?" (T. at 38).

Second, he noted that the tax situation with respect to alternative market mechanisms was "very cloudy." (T. at 38).

Finally, he questioned whether the alternatives provided a regulatory system that would meet the needs of small and medium sized businesses. (T. at 39).

Mr. Robert Larsen, an officer of the Insurance Administration Center, observed that there was "insurance company apathy and unpredictability" in regard to product liability. (T. at 40). He cited examples of cancellation of self insurance programs by commercial insurers. (T. at 42). For example, he indicated that a group formed by Mr. Urbanski for the Associated Equipment Distributors had its program "abruptly terminated by the Hartford." (T. at 42). That association then went to Marsh-McClennan who placed coverage with Zurich American. This company subsequently terminated the program. When Fireman's Fund, Inc. indicated it would take it over, it said it would only do so at increases between 100 and 700 percent.

He indicated that the example held out by Mr. Urbanski, as a successful captive, the National Welding Supply Association, had gone through numerous cancellations before it had formed the captive, WESCAP. Mr. Larsen read a letter from the legal counsel of WESCAP that indicated that prior cancellations had not resulted from "the group's loss experience, but from the insurance industry's overreaction in 1976 to the trend of product liability recovery." (T. at 44).

He indicated that WESCAP's viability as a captive was limited because the fronting insurer could always cancel, especially if they had "a change at senior policy levels." He noted that WESCAP could only function in Colorado, and required a fronting corporation to succeed. Finally, he noted that WESCAP and its Board of Directors urge and support the passage of the Risk Retention Act. He observed that as the industry starts to go into another loss cycle, cancellations by fronting groups were highly likely to occur.

He also indicated that while the Colorado captive statute has been in being since 1972, only one captive a year had been formed. He indicated that Bermuda was a much easier place to set up a captive, but questioned whether our national policy should, in effect, create incentives to go offshore.

He also questioned whether flexible regulation would lead to insolvent groups. He noted that Illinois had more insurance company failures than "the entire experience of Bermuda."

He cited letters from the groups that Mr. Urbanski had mentioned as having created their own captives under existing law. These letters strongly supported the passage of the Risk Retention Act. In essence, the groups were concerned that they could not rely on their fronting organization in case there was a downturn in the insurance market.

Mr. Harry House, President of Verlin, Ltd., a stock insurance company located in Bermuda, indicated that he had formed a captive for the National Paint and Coatings Association because of its members' need for increased liability limits, the fact that some of his members could not obtain adequate primary coverage, and that some members could not afford to purchase coverage because of the increase in premiums. He observed that in the current market, there was the use of higher deductibles in higher levels of primary coverage required for umbrella availability. (T. at 52). This created a "dilemma for small manufacturers."

In support of the assumption that the Risk Retention Act would create competition, he cited an example of a member who received a 50 percent rate reduction from a commercial insurer when the commercial insurer was advised that the potential customer was considering obtaining insurance from a captive. He indicated that this was not at all an isolated case. In one example, the insured received a savings in excess of $500,000 in a two year period of time. He indicated that the Risk Retention Act is necessary for small manufacturers because it was impossible for his group to meet the needs of all of his association members.

Mr. Louis Marchese, Counsel of the National Association of Wholesalers-Distributors, indicated that his group has obtained tort reform which limits the loss exposure of wholesaler-distributors. However, commercial insurers have not reduced rates but rather have taken a "wait and see" attitude. (T. at 56). He indicated that members of NAW who have formed self insurance groups have generally had to rely on foreign insurers to make the group effective.

Mr. William Dennis, Research Director of the National Federation of Independent businesses, discussed the insurance possibilities for small business. He indicated such businesses could make use of Title II of the Act because they could form new groups that would be able to bargain with commercial insurers for lower rates and premiums. (T. at 61).

Mr. Jim Mack, Public Affairs Director of the National Association of Machine Tool Builders, observed that insurers had gotten the attention of small businesses by raising rates. He submitted for the record the names of sixty small business groups that support the need for the Risk Retention Act.

He indicated that the Tennessee and Colorado laws had serious shortcomings. First, they were not helpful when numerous members of a captive were located in another state. He observed that the "fronting alternative" was not feasible became product sellers would still have to rely on the commercial insurance industry to obtain the fronting group. This would place control in the very industry that had engaged in "panic pricing" and help precipitate the product liability problem.

NATIONAL ASSOCIATION OF MANUFACTURERS,
Washington, D.C., July 11, 1980.

Senator HOWARD CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR SENATOR: On June 3, the NAM Product Liability Committee endorsed the "Risk Retention Act of 1980", H.R. 6152/S. 1789. At that meeting, some concern was expressed over the Federal chartering aspects of the legislation.

We are very encouraged by and supportive of your new staff bill as drafted; we believe it accomplishes what the original bill did without the Federal presence. The Association hopes that the Committee will move ahead with markup as soon as Congress returns from recess. It is our primary objective to secure passage of this crucial insurance option before the close of the 96th Congress.

This new proposal more than adequately addresses the concerns of the insurance industry, and it is now time to take positive and constructive steps to move it through the Senate Commerce Committee.

We comment you for the expeditious development of this new and creative approach and will do everything we can to garner support for its passage.

Thank you for yur help and concern.

Sincerely,

DAVID P. SLOANE.

CRUM & FORSTER INSURANCE CO.,
Washington, D.C., July 14, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: As members of the American Insurance Association and major writers of product liability insurance, we have been asked to comment on the June 30 Staff Working Draft of the Product Liability Risk Retention Act (S. 1789).

We are not in principle opposed to Federal legislation that would enhance competition in the insurance business, so long as it respects the policy of the McCarran-Ferguson Act that insurance be regulated by the States.

Our objection to S. 1789 is that it creates a Federal bureaucracy whose sole function would be to charter and regulate association captive insurers that could more easily be created and regulated by the States.

The Staff Working Draft eliminates this objection by replacing the Federal chartering authority with provisions which would simplify the interstate operations of risk retention groups without depriving the States of their authority to subject these groups to their tax and consumer protection requirements.

We have no objection to Federal legislation, like the Staff Working Draft, that would enhance equality of competitive opportunity in the provision of product liability insurance within the framework of State law.

Sincerely yours,

LESLIE CHEEK III,
Vice President, Federal Affairs.

National Association of Wholesaler-Distributors,
Washington, D.C., July 14, 1980.

Senator Howard W. Cannon,
Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

Dear Mr. Chairman: This is in response to your letter of June 30 requesting comment on the staff working draft of the "Product Liability Risk Retention Act of 1980" which you forwarded with same.

We have reviewed the draft bill carefully and have had the opportunity to discuss its provisions with Mr. Mullen of the Committee Staff.

NAW enthusiastically and fully endorses the working draft as a creative, viable alternative to S. 1789. We urge that the Committee act promptly to report a bill which incorporates the working draft to the full Senate at the earliest possible moment.

This endorsement is made on behalf of the 43,000 wholesaler distributors who constitute the membership of our 116 affiliate national associations shown on the enclosed list. In the interest of time we have already given Mr. Mullen our recommendations for specific changes in the provisions of the bill. These were minor, as we believe the working draft should be finalized into a bill and reported without essential change in its scope or language. In forwarding these comments to you I would be remiss were I to fail to extend our compliments to your and your staff for the sensitivity reflected in the working draft to the concerns of proponents and opponents of the Risk Retention Act. The working draft is a skillful work product which fully accommodates the objections raised by the insurance industry, in our view, while meeting the needs of the thousands of businesses which support legislation in this area. We stand ready to cooperate fully with the Committee as it moves to finalize this legislation.

Respectfully yours,

Dirk Van Dongen,
Executive Vice President.

Pulp & Paper Machinery Manufacturers' Association,
Washington, D.C., July 14, 1980.

Howard Cannon,
Chairman, Commerce, Science, and Transportation Committee,
Senate Office Building, Washington, D.C.

Dear Mr. Chairman: We have reviewed with considerable interest your draft product liability bill. Our initial assessment is favorable and copies have been sent to key industry executives for their review and comment.

You may be interested to know that product liability is the single most serious problem our industry faces. One dimension of special interest is that for the first time, imports of pulp and paper machinery to the U.S. exceeded our exports. Exposure to product liability suits could be a factor in this important new development.

We are pleased that your Committee has studied and acted on this important issue.

Sincerely,

Frank McManus,
Executive Director.

Laundry and Cleaners,
Allied Trades Association, Inc.,
Upper Montclair, N.J., July 14, 1980.

Hon. Howard W. Cannon,
Chairman, Senate Commerce Committee
Senate Office Building, Washington, D.C.

Dear Senator Cannon: As President of LACATA, a national association representing 350 manufacturers and distributors supplying the majority of equipment and supplies sold into the textile maintenance industry, I am writing to strongly urge prompt committee action on S. 1789.

The Risk Retention Act, currently pending before your Senate Commerce Committee, will provide a much needed alternative to develop group product liability approaches, resulting in more competitive premiums from commercial carriers.

We urge that the Risk Retention Act be reported out of Committee to the full Senate.

Your prompt attention to and support of this request for action on S. 1789 will be appreciated.

Sincerely,

Douglas J. Ramsey, *President.*

Risk and Insurance Management Society, Inc.,
New York, N.Y., July 15, 1980.

Hon. **Howard W. Cannon**,
Chairman Commerce, Science, and Transportation Committee,
Dirksen Office Building, Washington, D.C.

Dear Senator Cannon: I would like to compliment your vastly improved version of the Risk Retention legislation which I understand is being prepared for Senate consideration. The new bill has dealt with all of the major reservations expressed by RIMS in its comments to the original form of a Risk Retention Act under consideration in the House (H.R. 6152).

RIMS represents over 3,500 corporations including 85 percent of the Fortune 500 list. Our deputy members number over 6,500 and these risk managers are responsible for the maintenance of insurance and self-insurance programs for their companies. On behalf of our members, we heartily endorse, the Senate proposal and we concur that state insurance departments are the proper vehicles to administer the act without creation of any new Federal Regulatory bureaucracies.

Although RIMS supports the measure, my association has some reservations which I would like to outline for you:

1. Our members in deciding whether to form Risk Retention Groups, will have to decide if they are willing and/or able to subject themselves to open-ended post assessment obligations. The fact that these post assessment requirements may be proportional to the groups' premium volume in relation to total volume does not preclude the possibility that such assessments could be very dangerous for small business entities participating in the groups particularly since the language of the draft suggests assessment exposure in all states when coverage of the Risk Retention Group is applicable.

2. I was troubled by the practical effect of requiring Risk Retention Groups to become chartered under state law as insurance companies. If state regulators make capacity requirements more stringent than is absolutely necessary, the results could be that these requirements may make Risk Retention Groups economically less feasible.

It is my hope that state regulators, in dealing with these groups will keep in mind the purpose of this act and exercise their regulatory powers with restraint.

3. Section 2(a)(4)(C) defines "Risk Retention Group" to include "any corporation or other limited liability association . . . which is chartered as an insurance company under the laws of any State or foreign nation . . .". I have discussed with your staff my concerns and the expressed views of other members of my association, that this general acceptance of all foreign chartered entities could expose the public to the possibility of insolvencies which would preclude legitimate interest of the public to have such entities adequately funded, but also think that there has been a tendency on the part of state regulators to be overly protective and thereby, discourage the development of units of this type without the impetus of a federal mandate. To remedy this potential problem, we have suggested certain modifications to the draft. A copy of a proposed amended section 2(a)(4)(C), along with a deemer clause proposed as a new section 3(c), is enclosed.

Again, let me congratulate you on your excellent effort. My organization will be happy to assist you in any way possible to assure that your version of this legislation is enacted into law.

Very truly yours,

Edith F. Lichota,
Vice President, Governmental Affairs.

NATIONAL ELECTRONIC DISTRIBUTORS ASSOCIATION,
Park Ridge, Ill., July 15, 1980.

Senator HOWARD W. CANNON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR CANNON: NEDA consists of over 500 companies nationwide engaged in wholesale distribution of industrial electronic parts and equipment and the full range of consumer and commercial electronic products. Through our membership in the National Association of Wholesalers, we have been privileged to review the staff working draft of the Product Liability Risk Retention Act of 1980. We strongly approve of and wish to compliment you for the approach taken in the draft. This approach promises to provide significant relief for the product liability insurance problems being experienced by virtually all of our membership.

We sincerely thank you and your staff for development of this innovative approach. We urge prompt action to speed this bill to full Senate consideration.

Sincerely,

J. T. MACK,
Executive Vice President.

SPECIAL COMMITTEE FOR
WORKPLACE PRODUCT LIABILITY REFORM,
Washington, D.C., July 16, 1980.

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: We recently received a copy of the Working Draft of the Risk Retention Act which was prepared by the staff of the Senate Commerce, Science, and Transportation Committee. We believe that the staff has made a sincere and good-faith effort to resolve the issues in conflict which developed in testimony before the Commerce Committee on April 22, 1980 and at the meeting sponsored by the Department of Commerce on May 21, 1980. We support the Working Draft and urge that the Senate Commerce Committee schedule a markup as soon as possible in order to expedite the passage of this much needed legislative relief.

We believe that the Working Draft could be improved by making certain technical changes. Section 3(a)(2) could be expanded or report language could clarify the intent that contributions to an insolvency guaranty fund would be in proportion to premiums generated in that state by the Risk Retention Group (RRG) as compared to those generated by the total premiums generated by other guaranty fund contributors. Section 2(a)(4) should retain RRG's formed in foreign nations. However, we would not be opposed to limiting such coverage to foreign nations in which offshore captives are currently being formed. Section 3(a)(1)(A) should be conditioned on nondiscriminatory application of such claims settlement practices to RRG's. In Section 4(a)(3) we believe the words "or brokers" should be inserted in the second line after the word "agents". We would be pleased to discuss these recommended changes in more depth at your convenience.

Our organization represents a wide spectrum of capital equipment machinery manufacturers, distributors and marketers including 7,000 companies with a total annual sales volume in excess of $30 billion, employing aproximately 2 million employees and operating in all 50 states. We are concerned about the serious product liability problem which is facing American business today. We believe that the staff Working Draft of the Risk Retention Act will offer much needed short term relief for this problem.

You have already received a copy of the testimony which our General Counsel, Robert Taft, Jr., submitted to the Senate Commerce Committee to be included in the record of its hearings on April 22, 1980. That testimony outlines in detail the severity of the problem and the reasons why we believe both S. 1789 and the staff Working Draft offer viable short range relief for what has been termed availability/affordability insurance problem. The staff Working Draft of the Risk Retention Act will facilitate the operation of RRG's by those companies who need to cover their product liability exposure throughout the United States. It will guarantee that injured parties will have a fund from which they can recover. The many small companies that cannot afford to buy insurance on the commercial market today cannot offer that assurance at this time. It will also protect such companies from the threat of bankruptcy which they could face as a result of a major product liability suit.

I believe that you will find that the staff Working Draft of the Risk Retention Act will be supported by representatives of business, consumers, and the trial lawyers. However, it is possible that this legislation may be opposed by some elements of the insurance industry which have not been responsive to, or are incapable of responding effectively to the product liability insurance problem facing American business today. The staff Working Draft of the Risk Retention Act is a creative response to the primary issues which were raised by the insurance industry in opposition to S. 1789. If the insurance industry opposes the good-faith compromises in the staff Working Draft of the Risk Retention Act, we believe that such opposition would be unreasonable and an additional sign of the bad faith which has pervaded their opposition to this legislation all along.

Representatives of the insurance industry and the Department of Commerce have predicted that their will be a sharp increase in product liability insurance premiums in the next few years. With the problem being as serious as it is now, we are alarmed at the prospects of even higher product liability insurance premiums in the near future. The staff Working Draft of the Risk Retention Act offers a market alternative to small businessmen in the United States who are threatened by product liability risks. The need for this alternative is made even more important in light of the product liability insurance crisis which is predicted for the early 1980's.

We thank you and the Committee staff for your efforts in finding a solution to the conflict which has arisen over this legislation. We continue to offer our assistance to you and the Committee as you proceed to markup and report this legislation for full Senate consideration.

ROBERT TAFT, Jr.,
General Counsel.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
Washington, D.C., July 16, 1980.

Senator HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: NFIB, on behalf of its 610,000 small and independent business members, supports your working draft of the Product Liability Risk Retention Act of 1980.

Products liability insurance continues to be a problem for numerous small businesses, and we continue to view it as both insurance and tort law caused. Your working draft, if enacted, would significantly reduce the supply portion of the problem. Resolution of the other part of the problem will have to be sought by associations like ourselves at the State level.

NFIB applauds your initiative in offering this draft, and urges its enactment. We stand ready to assist you.

Sincerely,

JAMES D. "MIKE" MCKEVITT,
Director of Federal Legislation.

AMERICAN MACHINE TOOL DISTRIBUTORS ASSOCIATION,
Washington, D.C., July 16, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR SENATOR CANNON: The American Machine Tool Distributors' Association is a trade association representing the interest of machine tool distributors and builders in the United States. Both of these groups have been adversely affected by skyrocketing product liability insurance rates.

AMTDA has reviewed the Committee draft of the Product Liability Risk Retention Act of 1980. AMTDA strongly endorses the approach taken in the Committee draft and believes that it constitutes a workable approach to solving the liability insurance problems of the machine tool industry.

On behalf of AMTDA and the machine tool industry, I would like to thank you and the Committee staff for developing the working draft.

If AMTDA can be of any assistance to you in advancing this important legislation, please don't hesitate to contact me.

Sincerely,

ROBERT A. GALE,
Executive Vice President.

ASSOCIATED EQUIPMENT DISTRIBUTORS,
Oak Brook, Ill., July 16, 1980.

Senator HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: I had an opportunity to meet with Mike Mullen of the Committee staff last Thursday to discuss the provisions of the working draft of the Product Liability Risk Retention Act of 1980. The Associated Equipment Distributors has been an ardent supporter of S. 1789 since its inception, and we were at first wary of the new approach to our product liability problem contained in the working draft. However, after some study, and the very informative session with Mr. Mullen, we have concluded that the draft represents an eminently workable method to alleviate our problem, and we fully support it.

One of the major objections to S. 1789 is a belief by some opponents that it results in substantial federal intervention in the regulation of insurance. Although AED is concerned about excessive federal intervention in virtually all fields, we felt that the extreme severity of our product liability problem justified the regulatory framework contained in S. 1789. We did not consider it to be at all excessive. The working draft totally eliminates any concern which we had in this area by removing the federal presence in the regulation of risk retention groups. AED, as do many other groups, believes that state regulation is preferable to federal regulation whenever it is possible to choose, and that the working draft, in choosing state regulation, has eliminated any problems in this area.

Now that the objections that some organizations had to S. 1789 have been met, I must strongly urge that your committee move forward expeditiously to enact Risk Retention. The severity of our product liability problem can hardly be overstated. For AED members, 1,100 distributors of construction and mining equipment, premium costs border on the prohibitive and coverage, if available, is totally unreliable due to the commercial insurance industry's long history of abrupt cancellation. If, as has been frequently predicted, the product liability insurance market undergoes another severely disrupted period over the next few years, AED members will find some alternative to that market absolutely essential. Risk Retention provides that alternative.

The members of AED deeply appreciate the amount, and quality, of the work done by you, your committee and staff on this critical problem. We can only hope that these efforts of the last two years were not expended in vain and that Risk Retention can be enacted this year.

Very truly yours,

JOHN T. O'LEARY,
Manager, Washington Services.

MACHINERY DEALERS NATIONAL ASSOCIATION,
Silver Spring, Md., July 16, 1980.

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR CANNON: I believe you already know our desire for legislation to prevent the small companies in our industry from experiencing future difficulties in attempting to purchase adequate and reasonable product liability insurance. We are impressed with the comprehensive, swift and pragmatic work of your Commerce Committee in its consideraiton of the Product Liability Risk Retention Act.

During the past week our product liability counsel has had the opportunity to review the draft of the revised legislation with us. We now completely endorse this proposal. We feel this draft reflects the excellent work of your Committee.

The 400 U.S. firms of this organization are small businesses and we think the proposed Risk Retention bill is a workable solution to this product liability insurance problem. We hope it can be recommended for full consideration at this time and that you concur.

With regards,

ANTHONY SCHOPP,
Executive Vice President.

NATIONAL ASSOCIATION OF INSURANCE BROKERS, INC.
Washington, D.C., July 14, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation, Washington, D.C.

DEAR SENATOR CANNON: We have reviewed the staff working draft of the Risk Retention Act and find it, with some reservations, to be a workable bill. This bill represents a major improvement over H.R. 6152, and we applaud your efforts and those of the Committee and staff. We appreciate that you have listened to our concerns, as well as to others, and have attempted to balance the criticisms with the apparent need for the legislation which proponents claim.

Traditionally, the NAIB has been opposed to any federal intervention into the state regulation of insurance. However, the minimal intrusion into this relationship is acceptable for the specific purposes outlined in the bill; i.e., the establishment of risk groups and purchasing groups with the ability to function interstate, unimpeded by conflicting state regulation.

If the fundamental question of Congress's ability to force states to sanction the operations of groups formed in other jurisdictions is answered positively (to which there is some skepticism), then there are specific provisions of the bill which we believe need clarification as to their practical effect. For example: What constitutes a "competitive advantage" for members of a risk retention group (Sec. 2(a)(4)(d))? What is "indirect regulation" (Sec. 3(b)(a))?

The inclusion of offshore captives in the definition of risk retention group (Sec. 2(a)(4)(c)) is both welcome and troublesome. We believe there needs to be a further refinement which will narrow the scope of allowable foreign risk retention groups to those which can demonstrate they have satisfied adequate solvency requirements, such as the present laws of Bermuda and the Cayman Islands.

There are other sections of the bill to which we give our support: (1) the rescission of state countersignature laws for agents and brokers of risk retention and purchasing groups (Sec. 3(b)(4) and Sec. 4(b)(8)); and (2) allowing agents and brokers licensed in one state to act in that capacity for purchasing groups in other states (Sec. 4(a)(3)).

We believe these sections can be the beginning of the end to the anti-competitive effects which countersignature and "fictitious group" laws have had on insurance. It has been our longheld and fundamental belief that the states themselves should repeal these laws, and we will continue to urge them to do so. As commercial brokers, we welcome the opportunity to compete in all states, as we welcome the competition from others.

As commercial brokers, we seek to provide our clients the best possible range of insurance coverage. The risk retention group and group purchasing arrangements, as envisioned by this legislation, will be additions to the many options for brokers to consider for their clients.

We appreciate the opportunity you have given us to comment on the staff draft of the Risk Retention Act and will continue to offer our expertise to you and the staff throughout the consideration of this legislation.

Sincerely,

BETH KRAVETZ,
Counsel, Director of Government Relations.

REINSURANCE ASSOCIATION OF AMERICA,
Washington, D.C., July 17, 1980.

Senator HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR CANNON: The Reinsurance Association of America appreciates your invitation to submit comments on the staff working draft under consideration as an alternative to S. 1789, the proposed Product Liability Risk Retention Act of 1980.

We have now had an opportunity to review the document and, while we continue to believe that the legislation is unnecessary, the abandonment of the federal chartering concept represents a major improvement over the previous measure. Although there are several public policy and technical issues which will probably be the subject of comments from other organizations, they do not directly relate to the participation of reinsurers in the operation of risk retention groups.

While we do not feel that the present legislation adversely affects reinsurers we should perhaps, add the caveat that this does not mean that reinsurers will support each and every risk retention group which may be established. The decision to do business with a specific group will be made only after an analysis of such factors as the group's organization, management experience and plan of operation.

If we can be of further service to you or your staff in this matter, please let us know.

Sincerely,

JAMES M. SHAMBERGR.

STATE OF NEW JERSEY,
DEPARTMENT OF INSURANCE,
Trenton, July 17, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee of Commerce, Science, and Transportation,
U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR CANNON: Thank you for the opportunity of providing comments on the staff version of the Products Liability Risk Retention Act. Although I did not attend the meeting convened by the Department of Commerce at the request of the Committee, I was, nevertheless, able to hear and discuss the issues with the NAIC Products Liability Task Force during the Annual Meetings in Denver this past June. The New Jersey Department has previously testified before your Committee in favor of the original Administration version of the Risk Retention Act S. 1789 as passed by the U.S. House of Representatives. In testimony presented before your Committee on April 22, 1980, our reasons for support of the original proposal were outlined together with several suggestions for improvement of the Act. Among the latter were: requirements of approved risk retention groups to be members of state property liability guaranty funds; granting of formal rehabilitation and liquidation authorities modeled after existing state insurance laws to the Secretary of Commerce; and adoption of a "standby" provision for establishment at the determination of the Secretary of Commerce of a market availability syndicate.

The Senate Commerce version of the Risk Retention Act is directed at achieving three objectives arising out of the meeting with witnesses and experts convened by the Department of Commerce. They are:

To reduce or eliminate federal regulation of risk retention groups that may duplicate authorities of existing state and foreign insurance departments;

To assure compensation to persons making claims to risk retention groups by permitting them to join applicable state guaranty funds;

To eliminate state insurance statutes or regulations that would bar the formation of so-called purchasing groups; and

To exempt risk retention groups from applicable federal securities and state blue sky laws.

At the Department of Commerce meeting, insurance experts argued that the existence of state and foreign captives laws constitutes prima facie evidence that risk retention mechanisms exist and are being used to resolve present products liability availability/affordability difficulties. Moreover, it is their position that mass merchandising laws and regulations have the effect of denying products manufacturers and sellers the opportunity to purchase conventional coverages on a group basis. Their contention is that by reducing multiple state barriers against the operations of captives and purchase groups, that the bulk of the products liability availability problem will dissipate. The State Commerce Committee directed the development of this alternative version of the Risk Retention Act as a means of resolving these fundamental difficulties identified by insurance experts and other witnesses in the Meeting held by the Department of Commerce. The Senate Commerce Committee also has recognized that other requirements such as the necessity to assure product accident victim compensation, require membership of risk retention groups in some form of guaranty fund. The present staff version was developed to deal expressly with these observations and suggestions of insurance experts and witnesses.

It is the Department of Insurance contention that the Senate Commerce staff version is unfortunately bad insurance law. For it neither achieves these objectives nor does it solve the problems addressed by the House-passed version. It will, if anything, make them worse. The proposed bill has several deleterious and contradictory effects. First, it would make risk retention groups formed under either state or foreign insurance laws subject to little or no regulatory oversight. This is akin to problems encountered by many state insurance departments regarding the multistate operations of informed group trusts in the life, health and accident field and, especially, Multiple Employer Trusts (METs) under ERISA. Second, it would deny assurance of compensation to claimants in the wake of a possible "failure" of a risk retention group. This is because the "groups" would be treated under the majority of state insurance laws as surplus or non-admitted carriers for which virtually no state has provision for establishment of a guaranty fund. Third, the proposed bill raises the prospects of retailatory premium tax "wars" between state jurisdictions in which groups administer risks beyond their domicilliary jurisdiction. Fourth, the bill would maintain incentives for export of capital to foreign insurance jurisdictions in contradiction of both federal and state efforts to stem this flow of funds through formation of free trade zones, insurance exchanges (Illinois and New York) and deregulated commercial facilities (New Jersey).

The method of permitting group purchase of products liability coverages, as developed in Section 4 of the Senate Commerce staff version, may be unnecessary. Most states, New Jersey among them, permit approval of group blanket policy forms for many commercial lines including products liability. The approach taken by Section 4 is to remove the alleged impediments of so-called "fictitious fleet" statutes and mass merchandising regulations for the formation of so-called purchasing groups for products, completed operations and commercial liability coverages. It is the view of this Department that this may be unnecessary, as purchasing groups can be formed in single states under approved blanket policy forms. If the effect of Section 4 is to extend this provision to multi-state risks, then a different approach might be taken. The Senate Commerce staff might consider preempting state insurance laws and regulations that prevent the development of group blanket policy forms and subsequent reference to such approvals as may be granted by individual state insurance departments. Alternatively, the Committee might consider the preemption of state policy forms filing requirements for group blanket policies with an established aggregated annual premium in excess of $100,000. This would be consistent with similar provisions of thresholds for free trade zones (Illinois and New York) and deregulated commercial facilities under consideration in New Jersey.

In light of these deficiencies, we would suggest that the Senate Commerce Committee might return as a starting point to the original Administration proposal adopted by the U.S. House of Representatives. If the Committee wishes to avoid "piercing the veil" of the McCarran Ferguson preemption against federal regulation of insurance, there is an alternative. The alternative would be a federal standards bill for establishment of risk retention groups by states who elect to adopt this solution, coupled with provisions for eliminaton of laws and regulations that bar adoption of group blanket policy forms. Additionally, the Committee might wish to extend authorities to states who may elect to establish market availability syndicates modeled after the Federal FAIR Plan Program for conventional writing of products and related commercial liability coverages. We would also suggest the inclusion of provisions to address disclosure of certain forms of products liability ratemaking such as "a" or guide rates along the lines of regulations recently promulgated by the New York Department Insurance (See First Amendment of Regulation No. 57, 11 NYCRR 160 dated May 29, 1980).

Despite these suggestons, the federal standards approach for creation of state risk retention groups would not result in the most efficient multi-state arrangements for transfer and sharing of products manufacturers and sellers risks. However, it would be more effectve than the present Senate Commerce Committee version. It is still the position of the New Jersey Department that the best solution lies with the adoption of a federal enabling law for the creation of nationwide risk insurance laws for group purchase of insurance and mandatory membership in property and liability guaranty funds.

On behalf of Commissioner Sheeran and the New Jersey Department of Insurance, we appreciate this opportunity to respond to your draft proposed bill. We hope that the comments and criticisms have been constructive and helpful in the deliberations for a Senate version of the Risk Retention Act.

Sincerely yours,

Jerome B. Gordon,
Special Assistant for
Research and Information Systems.

INSURANCE ADMINISTRATION CENTER, INC.,
Park Ridge, Ill., July 17, 1980.

Senator HOWARD W. CANNON,
Chairmam, Committee on Commerce, Science, and Transportation,
U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

Thank you for taking the time to present an overview of the draft of the revised "Product Liability Risk Retention Act of 1980". I feel it represents a sensible compromise to the conflicting positions of commercial insurance buyers versus insurance sellers.

In the days following, I had an opportunity to discuss the position of the American Insurance Association as well as that of several major casualty underwriters. In the first of these discussions, Dennis Connolly of AIA expressed the belief that his association will oppose the compromise bill in the belief that this legislation will:

1. Dismantle decades of effective State regulation.
2. Expose insurance buyers to charletans posing as organizers and managers of risk retention groups.
3. Create unfair competition for insurance companies.
4. Leave corporations, insured through risk retention groups, unprotected by virtue of exclusion from state-run solvency guarantee funds.

I firmly believe these claims can be refuted by looking to the factual situation:

1. The Risk Retention Act is a practical, necessary legislative device through which commercial insurance buyers can fund for and share their product liability exposures in the decade ahead.
2. Given the volatile pattern of product liability, pricing and availability (as witness the decade of the 70's) the Risk Retention Act is needed as an alternative to an unresponsive and unpredictable domestic insurance marketplace (in advance of the impending downswing in the insurance cycle universally predicted for the year ahead).
3. As to "exposure to charletans", it is instructive to note that such exposure already exists since insurance buyers are encouraged to select Bermuda or the Caymen Islands as their place of domicile and, indeed, a large percentage of the major U.S. insurnace companies operate subsidiaries in those countries for this specific purpose.
4. As to the need for solvency guarantee funds, it's important to distinguish between insurance entities selling to the public at large versus risk retention groups whose risk assumption will be limited to its incorporators.

I am concerned with a phone conversation I had with a senior executive of The Hartford Insurance Group. The Hartford's position was characterized as one in which it was perceived to be not in the best interests of The Hartford to propose any Federal legislation aimed at expanding competition within the domestic insurance marketplace. It was inferred that The Hartford, and many other casualty companies were resolved to resist any Federal initiative aimed at fostering competition for product liability insurance. I suggested that satisfying the reasonable and logical demands of commercial insurance buyers for an alternate to the sometimes chaotic causalty insurance marketplace was, indeed, in the best interest of insurance companies (especially those wishing to avoid an expanded Federal role in the regulation of insurance).

I am, however, pleased to report that several other major casualty underwriters have taken a much more enlightened view of the Senate staff revisions to the Risk Retention Act. At the least, some insurance industry leaders havee elected not to oppose your draft and may, in the days ahead, publicly support its passage

In closing, I extend my sincere appreciation for the efforts of Senator Cannon and his Committee, the Commerce Department, and especially you, Mike, for your efforts aimed at seeking a sensible compromise. I strongly urge prompt Senate Committee action on your revised bill.

Sincerely,

ROBERT L. LARSEN, *President.*

NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION,
McLean, Va., July 17, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
Russell Senate Office Building, Washington, D.C.

DEAR SENATOR CANNON: This is in response to your letter of June 30, concerning the staff working draft of the "Product Liability Risk Retention Act of 1980."

We strongly support the provisions of this working draft and our association urges prompt action by the Senate Commerce Committee on this measure at the earliest possible time. This draft, in our opinion, strikes an ideal balance between the concerns of the insurance industry with regard to the provisions of S. 1789, and the needs of business in obtaining available and affordable products liability coverage.

When one considers that over half of our members have no primary coverage, or have substantial deductibles under current policies, it is easy to see the need for immediate relief in this area. Enactment of this draft into law will make a major contribution toward the solution of our members' products liability problems.

The machine tool industry, and indeed the entire American business sector are deeply indebted to you and your staff for your exceptional foresight and skill in drafting such meaningful legislation. We pledge our working support to you and your staff in any way possible in efforts to move this measure promptly through the legislative process.

Sincerely,

James H. Mack,
Public Affairs Director.

National Tooling & Machining Association,
Washington, D.C., July 17, 1980.

Mr. **Michael J. Mullen,**
Senate Committee on Commerce, Science, and Transportation,
Russell Senate Office Building, Washington, D.C.

Dear Mike: Congratulations on the excellent job in drafting an alternative to the Risk Retention Act of 1979. It is our opinion that the language you and other members of the staff have authored will solve objections to the legislation based on the issues of states' rights as well as federal involvement in private enterprise. I have spoken to individuals on the staff of many of the associations who favored the Risk Retention Act, and to my knowledge, all of them are very happy with your substitute language.

Please express our appreciation to Senator Cannon and other members of the Committee staff for their contributions to this effort.

Cordially,

Bruce N. Hahn,
Manager of Government Affairs.

The Society of the Plastics Industry, Inc.
Washington, D.C., July 18, 1980.

Hon. **Howard Cannon,**
Chairman, Senate Commerce, Science, and Transportation Committee,
U.S. Senate, Washington, D.C.

Dear Senator Cannon: On behalf of the Society of the Plastics Industry, Inc., I am writing to express our support for the revised version of the Product Liability Risk Retention Act. The Society of the Plastics Industry, Inc. (SPI) is the major national trade association for the plastics industry, its membership representing an estimated 75% of the total volume of plastics sales in the United States. SPI is composed of approximately 1300 member companies and individuals who supply raw materials, process or manufactture plastics or plastics products, engineer or construct molds or similar accessory equipment for the plastics industry, and engage in the manufacture of machinery used to make plastics products and materials of all types. The majority of SPI members are small businesses.

SPI has been actively engaged in the efforts to restore equity and fairness to the products liability tort system. To this end, it supports adoption of the U.S. Department of Commerce Uniform Product Liability Act by the individual states.

SPI is of the opinion that manufacturers, particularly small manufacturers should also have the right to form insurance pools or to bargain collectively with insurance carriers as the Risk Retention Act would provide. We strongly support the revised version of that Act which has been prepared by your staff, and urge that it be passed this year.

Thank you for this opportunity to comment.

Sincerely,

Ralph L. Harding, Jr.,
President.

THE CONTINENTAL INSURANCE COMPANIES,
New York, N.Y., July 18, 1980.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: You may be aware that Continental Insurance Company has supported the concept of the risk retention legislation currently under consideration by your Committee.

In general, we believe that the Staff Working Draft recently circulated is on the right track. However, there is a feature which we believe needs further attention.

The Working Draft would preclude any state from prohibiting a captive company from doing business within its borders if the captive company is properly organized in some jurisdiction—domestic or foreign. There are many places in the world in which it is possible to form such a company with virtually no realistic capital requirements. As we read the proposed Working Draft, a company formed in one of those jurisdictions would automatically be entitled to do business anywhere in the United States. This could lead to serious problems of solvency.

A better alternative would be to require that any such company organized outside the United States must demonstrate to at least one state that it meets minimum standards of solvency equivalent to those required by the state. This would not be any kind of hindrance to legitimate captive companies and would preclude the possibility of a proliferation of ill-conceived programs attempting to take advantage of lax requirements in foreign jurisdictions.

Yours very truly,

WILLIAM S. GIBSON,
Vice President and General Counsel.

HALFPENNY, HAHN & ROCHE,
Chicago, Ill., July 19, 1980.

Senator HOWARD W. CANNON,
Chairman, Senate Committee on Commerce, Science, and Transportation,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR: I am writing as Legal Counsel for the National Association of Wholesaler-Distributors. We appreciate the opportunity provided by the Commerce Committee to submit comments on the Staff Working Draft prepared with regard to S. 1789, the Product Liability Risk Retention Act.

Our comments are brief. The Staff Working Draft is an excellent and sensible compromise which, we feel, fully answers the concerns raised by insurance industry representatives, yet preserves to product liability insurance purchasers the necessary alternative (or supplement) to commercial insurance.

The objections raised by the representatives of the insurance industry to S. 1789 focused on the role of the Federal government in overseeing the activities of risk retention groups. A related concern was the precedent such Federal regulation allegedly would establish, possibly leading to an erosion of the McCarran-Ferguson antitrust exemption now enjoyed by commercial insurers.

The Staff Working Draft completely satisfies these insurance industry objections. It removes entirely any role of the Commerce Department of any other Federal agency in supervising the activities of a risk retention group. Such regulation is left to the State or country in which the risk retention group is chartered.

Indeed, if there is continued opposition by the insurance industry to the concept of the Staff Working Draft, this to us is a position based *solely* on a desire to prevent increased competition in the domestic product liability insurance market. This is particularly disturbing to us since the "traditional" insurance market has in the past and will in the future provide this vital protection on a volatile basis in terms of affordability and availability.

The Draft also carefully recognizes the interest of the States other than the State of charter to regulate risk retention groups in the areas of claims settlement practices, premium and other taxes, and participation in state insolvency guaranty funds.

These regulatory requirements take into account that insurance offered through a risk retention group will not be offered for sale to the general public, but rather to a limited number of business purchasers. Also, each member of the group has a strong self-interest in seeing that the group is managed properly. Equally significant is the scrutiny placed on the group by its excess insurers and reinsurers.

Finally, we do not feel the Draft would—as some may contend—create unfair competition for the insurance companies. In fact, the Draft does not confer on risk retention groups advantages now conferred to commercial insurers. It does not grant risk retention groups the broad antitrust immunity which the insurance companies now receive under the McCarran-Ferguson Act. Nor may risk retention groups venture into areas of insurance other than product liability and completed operations.

We are most appreciative of your efforts and the efforts of Senator Cannon and the Committee to help resolve the differences that have developed on this legislation. We trust these efforts will result in favorable Committee consideration to give wholesaler-distributors and other businesses the crucially-needed alternative to commercial insurance.

Very truly yours,

George W. Keeley.

Scientific Apparatus Makers Association,
Washington, D.C., July 18, 1980.

Hon. **Howard Cannon,**
Chairman, Senate Committee on Commerce, Science, and Transportation,
Dirksen Senate Office Building, Washington, D.C.

Dear Mr. Chairman: The purpose of this letter is to respond to your invitation for public comments on the staff working draft of the Product Liability Risk Retention Act which was prepared as a result of the April 22, 1980 hearings before your Committee and subsequent hearings on the issue by the Department of Commerce.

The Scientific Apparatus Makers Association has had a long interest in the proposed Risk Retention Act developed by the Department of Commerce, and did support the legislation as it progressed through the House. We also communicated our association's support for the provisions of S. 1789 to you and other members of your Committee in a letter dated May 12, 1980.

In light of the fact that we only this morning received a copy of the staff working draft which would, substantially revise some of the concepts underlying S. 1789, we are not at this time in a position to formally endorse the proposed draft. However, one of the concerns we had expressed relative to the original Department of Commerce proposal and subsequent revisions to it related to the fact that over-enthusiastic Federal regulation of a risk retention program would result in the failure of companies to take advantage of the stated objective of the legislation; that being to facilitate the formation of risk retention groups.

In light of these previously stated concerns by SAMA, it would appear that your staff has developed an ingenious solution to the problem; namely to preempt certain laws which now adversely affect the operation of association captives, but not impose any new Federal regulatory authority over the operation of the groups.

As we understand the provisions of the staff working draft, the definition of a risk retention group provides that the group must obtain a charter from a state or a foreign nation authorizing it to act as an insurance company. The draft intends that the risk retention group would comply with all of the legal requirements imposed by the jurisdiction in which it is chartered. It would not, however, be required to meet multiple or conflicting regulatory requirements imposed by other states (except that it would be required to comply with claims settlement laws, pay state taxes, and participate on a non-discriminatory basis in any guarantee fund, if required by state law to do so).

Section 4 of the Staff Working Draft appears to be similar in content to Title II of H.R. 6152 which SAMA has already endorsed.

Section 5 of the Staff Draft adopts provisions of H.R. 6152 which exempt a risk retention group from the requirements of Federal security laws. SAMA has already endorsed these provisions as well.

As noted at the outset, SAMA has not had the time to fully evaluate the proposed new legislation, and therefore cannot offer its formal endorsement now. However, it appears that the working draft does present a creative and viable alternative to S. 1789.

In passing these comments on to you, we would be remiss if we did not express our compliments to you and the members of your staff for the creative approach you have taken in the working draft, and for you efforts to meet the concerns of the proponents and opponents of the Risk Retention Act. We will do everything possible to work with the Committee as it moves to finalize this legislation.

Sincerely,

Eben S. Tisdale,
Manager, Legislative Affairs.

American Mining Congress,
Washington, D.C., July 18, 1980.

Hon. **Howard W. Cannon,**
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: The American Mining Congress (AMC) appreciates the opportunity to comment on the "Risk Retention Act of 1980" (S. 1789). AMC is an industry trade association composed of most of the nation's producers of metals, coal, and industrial and agricultural minerals, as well as the manufacturers of mining machinery, equipment and supplies. The product liability issue has been and continues to be a matter of vital concern to all of our member companies. We commend your Committee for the consideration it has given to this subject.

The AMC Product Liability Committee at a meeting on May 6, 1980, endorsed the "Risk Retention Act of 1980." Committee members expressed the belief that enactment of this legislation will provide an immedaite remedy for many of the product liability insurance cost/availability problems currently confronting U.S. business. While continuing to support the enactment of tort reform measures by the individual states and federal proposals to permit the establishment of tax-exempt reserves/trusts to cover product liability losses as long-term solutions to the problem, the Committee believes that passage of the "Risk Retention Act of 1980" will provide an immediate and effective remedy to some of the most serious product liability problems.

We urge your strong support of this legislation and encourage final Congressional action on this measure by the 96th Congress.

With warmest personal regards, I am,

Sincerely,

J. Allen Overton, Jr.,
President.

American Textile Machinery Association,
Washington, D.C., July 18, 1980.

Hon. **Howard W. Cannon,**
U.S. Senate,
Washington, D.C.

Dear Senator Cannon: It is my understanding your staff is currently drafting language that would allow the joint purchase of product liability insurance in a manner that would eliminate federal regulation, yet supercede state laws that would hinder the formation and operation of such insurance groups.

The members of our association produce about 90% of the textile machinery made in the U.S. and for years they have been beleaguered by escalating product liability insurance costs. Anything that might help them reduce these costs would be very much appreciated.

The inequities and predicaments are clear. We urge speedy action.

Thank you.

Sincerely,

Harry W. Buzzerd, Jr.,
Executive Vice President.

Machinery & Allied Products Institute,
Washington, D.C., July 18, 1980.

Hon. **Howard W. Cannon,**
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Russell Senate Office Building, Washington, D.C.

Dear Chairman Cannon: We have received for comment from Mike Mullen, Legal Counsel of the Consumer Subcommittee, a copy of the staff working draft of a new bill entitled the "Product Liability Risk Retention Act of 1980." Like H.R. 6152, passed by the House of Representatives and earlier considered by the Senate Commerce Committee, this measure seeks to exempt from certain state laws, rules and regulations relating to insurance those organizations qualifying as product liability risk retention groups. The purpose of such groups would be to provide product liability and completed operations liability insurance to group members who might otherwise find it difficult to secure such coverage.

The Machinery and Allied Products Institute (MAPI), the national representative of capital goods and allied products manufacturers, earlier submitted to the Commerce, Science and Transportation Committee its formal statement regarding S. 1789, the original Senate risk retention bill. Therein we expressed our support for the concept of a risk retention group program and we are pleased to reaffirm that support with regard to this newest legislative initiative. We are also inclined to prefer the role of the federal government—or perhaps we should say the absence of any role for the federal government—envisioned in the draft bill as opposed to that provided for in H.R. 6152. However, we are concerned that this newest approach to the basic concept may be flawed on pragmatic grounds to the extent that it would fail to gain the needed support for passage into law. If one believes that legislation authorizing risk retention groups is necessary and desirable—and we do—then obstacles to passage which are likely to prove serious demand reexamination.

Our concerns may be summarized in two questions: (1) How would risk retention groups be identified? and (2) Once identified, what will be the tax status of amounts paid to such groups?

Regarding the first issue, the measure currently under consideration by the Subcommittee staff includes an extremely broad definition of "risk retention groups" but does not establish any mechanism for certifying or otherwise identifying organizations which qualify as risk retention groups. We suggest that this is of critical importance. With the status of any such group left uncertain, how shall state and federal agencies know which groups enjoy exemption and which do not? This absence of any clear indicia of status may effectively disrupt the safe harbor which the legislation clearly contemplates.

Our second concern is associated with the current federal income tax system. While this newest measure would include offshore subsidiary (captive) insurance companies as candidates for the designation "risk retention group," and while this approach may effectively overcome the obstacles of incorporation regulations imposed by certain states, few captive insurance companies are likely to incorporate domestically unless and until the tax structure is amended to provide sufficient assurance that corporate contributions thereto would be tax-deductible (as they are at present with commercial insurance companies). The current measure provides no such assurance and we are inclined to believe that few companies would be willing to gamble that the Treasury Department would automatically permit a tax deduction for contributions to an organization which did not meet its requirements for "insurance" (i.e., "risk spreading" and the "distribution of risks"). As you know, the House passed version, H.R. 6152, acknowledged this reality of the tax system and secured the implicit approval of the Treasury Department that tax-deductibility would be available for certified risk retention groups. No assurance of any kind is provided in this newest draft measure and we are persuaded that the tax issue is of paramount importance to the viability of the program.

We are grateful to the members of the Subcommittee staff who have worked diligently to promote the risk retention group concept. Again, we endorse the concept, as do many of our member companies. However, we must express our concern that this newest legislative draft may prove less than successful for the reasons outlined. We respectfully urge that the issues we have raised be given careful consideration.

Thank you for permitting us the opportunity to comment on the measure at such an early stage in its development. If we can be of any further assistance to the members of the Committee or its staff, please call on us.

Cordially,

CHARLES STEWART,
President.

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.,
Washington, D.C. July 22, 1980.

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN. The Independent Insurance Agents of America, Inc. welcomes this opportunity to submit commentary on the "staff working draft" of the Product Liability Risk Retention Act. We recognize and sincerely applaud the commendable efforts of the members and staff of the Committee on Commerce, Science and Transportation in striving for a reasonable bill, attempting to balance the legitimate concerns of the contending parties. We thus offer this statement as a constructive response to the changes evident in the new draft.

In general, we find a number of the revisions to be both significant and praiseworthy. In particular, the deletion of the authority granted to the U.S. Department of Commerce, in the House passed bill, to certify and regulate risk retention groups removes one of its most objectional provisions. As we testified repeatedly, this federal regulatory power would not only duplicate established state regulation in this area, it would directly contradict the statement of public policy contained in the McCarran-Ferguson Act which stresses the propriety of state regulation.

However, while we favorably note the removal of the physical presence of a federal regulatory body, we continue to have serious reservations about the broad preemptory language contained in this draft. Indeed, the implications of authorizing the insurance laws and regulations of any single state (or foreign country!) to prevail in all other state jurisdictions opens vistas not contemplated by the House passed legislation and raises questions not previously studied. While we have not as yet fully examined the ramifications of this provision, our initial analysis finds it to be confusing and troublesome.

In itemizing IIAA's specific concerns with this draft, we must advise that some of our evaluations may be tentative or speculative in nature. Also our primary attention is focused upon the impact this legislation would have upon the approximately 126,000 independent, property/casualty insurance agents that comprise our membership.

(1) As we have pointed out repeatedly in our testimony in both the House and Senate, current state laws, to the best of our knowledge, do not impede the establishment of products liability self-insured groups or group insurance plans. However, as a result of the concerns that have been raised, the National Association of Insurance Commissioners has made a commitment to take an indepth look to identify whether there are "true" impediments to the establishment of self-insured groups and group purchase of product liability insurance. We believe Congress should defer taking action until the NAIC has completed its study of these issues. We also believe there is a commitment within NAIC that if real impediments are identified, it will take prompt action at the state level to rectify these impediments.

We should note here that IIAA has formally advocated a policy that countersignature laws, specifically, are anachronistic and should be repealed through state action. However, even here there is no evidence that these laws seriously retard in any material way the ability of group insurance programs—or risk retention groups—to operate on an interstate basis. Quite the contrary, the existence of such groups has already been well documented.

(2) The pre-emption of state regulation contained in the Senate draft is entirely too broad to accomplish the stated goals of removing perceived impediments. Rather than pre-empt all state regulation except for two narrow areas, the approach might well be to identify true impediments and then pre-empt only those state laws creating the impediment. The over-broad pre-emption leaves the states in a position unable to protect the legitimate interests of their citizens. The result would be the creation of a regulatory vacuum.

As currently worded, Section 3(a)(1) would prohibit any regulation of a "risk retention group" "outside the place in which it is chartered" except with respect to claim settlement practices and premium tax laws. The pre-emption would not only apply to the risk retention group itself but to any person that sells such services or provides management services to the group. The net result would be that any state in which the risk retention group is operating, other than the chartering state or country, would not be able to police the practices of the group to make sure that unfair or deceptive insurance practices, sales practices, advertising, or management services are provided. Most important, the state would not even have the power, if the group's rates were either excessive or inadequate, to force their correction, or to take steps to assure the group's continued solvency, thereby forfeiting the security that the small businessman needs from such a group.

The abuses that will result in time from this vacuum in regulation will inevitably force federal regulation of these groups—initially, perhaps as a result of litigation in federal courts, but ultimately via congressional action—a result we firmly oppose because of our strong belief that state regulation is more effective.

Furthermore, even if the language of the bill were amended to permit the chartering state to attempt to regulate the operations of these groups in other states, we question whether the laws of the chartering state legally can be given such extraterritorial effect. Moreover, insurance departments cannot be expected to have either the resources or the controls set up to monitor the activities of such groups in other states. A recent controversial GAO report—entitled Issues and Needed Improvements in State Regulation of the Insurance Business—asserted that some state insurance departments are currently understaffed and underfunded. Such states obviously would be under considerable strain if required to monitor insurance activities in 49 additional jurisdictions.

(3) The Senate staff draft would permit individuals to solicit participation in "risk retention groups" who are not licensed outside the chartering state (Section 3(a)(1),

and would allow agents licensed in any one state to solicit insurance for a "purchasing group" in any of the other 49 states without procuring a license in that state (Section 4(a)(3).) We firmly believe that the right of each state to require licensing of the individuals that solicit participation in risk retention groups or group insurance within its borders be preserved so that the state will maintain adequate control over its agents, brokers, and other sales people to prevent unprofessional sales practices that are injurious to the small businessmen this bill is designed to protect. Such a result would reflect adversely on an industry seriously committed to upgrading its professionalism and service to the public.

It must be emphasized that IIAA could never knowingly endorse any legislation—irregardless of its intent or any other meritorious features—that unwittingly opens the door to such irresponsible or unprofessional conduct.

(4) Section 3(a)(2) provides the basis for a state to require, "on a nondiscriminatory basis" a risk retention group to participate in an "insurance insolvency guarantee fund." This is a laudable first step to protecting both risk retention group members and consumers in general from the consequences of insolvency.

However, it is unclear as to whether risk retention groups would be compelled to participate in the guarantee funds in all jurisdictions in which they have members or whether this is solely the prerogative of the domiciliary state. Would participation, even on a non-discrimnatory basis, be compulsory or discretionary? Also, the definition of "on a nondiscriminatory basis" is ambiguous. Its application and intent should be clarified in order to deter the likelihood of litigation.

(5) Section (3)(a)(3) provides that risk retention groups shall not participate in residual market mechanisms established under state law. We can see no reason to exclude these groups from residual market mechanisms to fulfill their obligation to the same extent that other products liability insurers do.

It is important to point out that many of the mutual and reciprocal companies in operation today originated in the same way as is proposed for risk retention groups, and their operations in time will be identical. Given the broad definition of "risk retention group" in the draft, it is likely that several of these in time will be considerably larger than good size commercial insurers today. Moreover, there is nothing in the draft to prevent the grouping of varied kinds of businesses in one "group" (that is, non-homogeneous risks). Thus, we are not just talking about the formation of a few association groups or captives. Formation of substantial commercial insurers are likely, calling themselves "risk retention groups", able to do business on a preferred basis over multi-line companies. The special privileges are unjustified and unfair.

(6) Both the section on risk retention groups and puchasing groups prohibits any state laws that ". . . otherwise discriminate against such a group or members thereof." The meaning of these sections are entirely unclear: What is meant by "discrimination", and discrimination in reference to what? Is it in reference to other group programs, other insurance companies, resident insurance companies? Unless further clarified, this would predictably lead to inconsistent interpretations by the several states and thus to substantial litigation.

(7) Section 2(a)(4)(D) would permit rank discrimination against similarly situated small businesses who for some reason or other are denied membership in a particular risk retention group. Businesses perceived to present a higher risk could be excluded from the group, and the group could justify it under the current wording arguing that the exclusion was not "solely" to provide the other members a competitive advantage. But, such a competitive advantage to members could certainly be the net result of such exclusion. Some standard must be included that assures fair treatment of all potential members of such groups.

(8) The definition of "purchasing group" contained in Section 2(a)(5) sanctions the pre-emption of state law with regard to any group that has as one of its purposes the purchase of products liability insurance. Thus, a group that purchases products liability insurance would be exempted from state regulation with regard to any of its group insurance programs, and its agents, insurers and suppliers of management services would be exempted with regard to products liability and other liability insurance. We know of no evidence that has been produced in the hearings on this issue that arguably justifies extending the pre-emption of state law to lines other than products liability.

In conclusion, we must stress that no persuasive evidence has been produced that documents the necessity for legislation preempting state regulatory authority in this area. On the contrary much testimony has been produced that clearly describes an environment currently conducive to the formation of association captives, "purchasing" (or safety) groups, etc.

If, however, after additional study the Committee remains convinced as to the necessity of federal legislation in this area, it would be well to consider a far narrower document. As we have indicated above, the ambiguous, and broadly preemptive language contained in certain provisions of the draft would result in unneeded havoc, extensive litigation and, ultimately, more pervasive federal involvement.

In our testimony on April 22, 1980 we noted the diversity and conflicting nature of the testimony that has been submitted to your Committee. We respectfully suggested that the Committee consider commissioning an "independent study" in order to reconcile this contradictory information. We were pleased that the Committee prompted the Department of Commerce to conduct a forum for this express purpose. However, as you are aware, the Department of Commerce has taken a leading advocacy role during the deliberations of this product liability insurance issue and may not be in the best position to be a dispassionate mediator. Now, especially considering the new vistas opened up by this staff draft, we would renew our request for further investigation, or additional hearings.

We are also well aware of the extensive efforts of yourself, your colleagues and the Committee staff to further research and refine this legislation. We will, of course, continue to make ourselves available to assist you in achieving your goal of arriving at truly responsive and responsible legislation.

Sincerely yours,

LAWRENCE R. HERMAN,
Director of Congressional Relations.

NATIONAL ASSOCIATION OF INDEPENDENT INSURERS,
Des Plaines, Ill., July 25, 1980.

Hon. HOWARD W. CANNON,
Russell Senate Office Building,
Washington, D.C.

DEAR CHAIRMAN CANNON: The National Association of Independent Insurers appreciates the opportunity to offer our views on the "staff working draft" of the Product Liability Risk Retention Act. We commend the fact that staff realistically recognizes that the problem confronting the Committee is an extremely complex one. The Senate Commerce Committee fortunately has not responded to outside pressure to enact a bill, no matter what the ultimate consequences, just to claim it has done something about the product liability "crisis".

The working draft has removed many of our original objections to the House version as outlined in our statement of April 22, 1980. However, the working draft has raised new problems for all interested parties. The deletion of authority to the U.S. Department of Commerce to administer the program removes one of the more objectionable provisions of the House version. NAII did not believe a new federal governmental bureaucracy was needed. Unfortunately, federal administration is replaced with only one state being responsible for a "risk retention group". Such a group would be able to operate in fifty states with only one state responsible for ensuring that a risk retention group has adequate assets to meet the risks that the gourp wishes to retain; if the group's reserves are reasonable and adequate to meet expected losses and loss adjustment expenses; determine whether excess insurance is required; and analyze to some degree the financial condition and operations of a group.

The insurance codes in effect in a state may not grant such specific power to an insurance department. State Insurance Departments would not have the authority to decide the adequacy and quality of the management of the group, or the adequacyh of a loss prevention program, or any of the internal workings of a risk retention group. This would seem to bring us to a "Catch-22" situation, creating an illusory need for federal supervision. However, it is clear that this concept contained in the House bill is not the answer as there is a complete absence of insurance expertise or experience in the Commerce Department or, for that matter, any other department of the Executive Branch, to comprehensively administer, in effect, hundreds of small insurance companies. Granted it probably could be done by creating a new federal bureaucracy staffed with the necessary experts. This obviously flies in the face of claims of no new costs to the federal government in creating the risk retention concept.

The true answer is to allow for complete state regulation by all states involved with a risk retention group—the insurance expertise is already in place. The "working draft" additionally indicates that there is no need for a federal law in this area. What this draft is trying to accomplish is already in place in at least two states, Tennessee and Colorado, with their Captive Insurance Company Laws.

We would direct the Senate Commerce Committee and its staff to the testimony of Colorado Insurance Commissioner J. Richard Barnes before the House Subcommittee on Consumer Protection and Finance in November, 1979. In response to claims by spokesmen from the Department of Commerce that the Colorado Captive Insurance Company Law was not being utilized, Commissioner Barnes made an excellent detailed presentation on that state's law. Included in that testimony was a list of 29 captives licenses in Colorado. Many of these captive companies licensed only in Colorado provide the needed coveage requirements in other states. Examples given by Commissioner Barnes are attached to this letter.

We would urge the Senate Commerce Committee to invite the Insurance Departments of Colorado and Tennessee to testify on the workings of their Captive Company laws.

The argument will quickly be made that the provisions of Captive Company Laws are too burdensome and would hamper the formation of "risk retention groups". A comparison of the requirements for the formation of a group under the House bill and the protections of the Captive Company Laws would resolve such arguments. An attempt to ease the creation of such groups to alleviate the product liability affordability problem should not overlook the greater need to protect the consumer public. State regulation of the insurance industry serves this need now, and thus should be fully utilized by any law under consideration in Congress.

While first proposing a federal guaranty fund, the Department of Commerce abandoned this concept and advanced the proposition that the Risk Retention Act would not prohibit approved groups from voluntarily joining a state insurance guaranty association. The working draft takes the approach that a state may require a group to participate in a guaranty fund. This is conditioned on the fact that it be on a nondiscriminatory basis. Frankly, we are at a loss to determine the meaning of this particular phrase. Ignoring this question, this provision creates problems with the current law in the majority of states. We assume that the intent of the drafters is that a group may be required to join guaranty funds in nondomiciliary states.

The current NAIC Model Post Assessment Guaranty Association Act, adopted in the majority of states, defines a member of the Association as: "any person who: (a) writes any kind of insurance to which this Act applies under Section 3, including the exchange of reciprocal or inter-insurance contracts; and (b) is licensed to transact insurance in this state".

Only member companies are assessed for insolvencies by the State Guaranty Association.

Should an insolvency of a multi-state self-insurer occur, only those guaranty funds in which the insurer is a member would be triggered. If a company were only licensed in one state, as with surplus lines companies for example, claimants in foreign states would not be eligible for payment since guaranty funds only cover claims "where the claimant or insured is a resident of this state at the time of the insured event".

Thus, claimants in foreign jurisdictions would bear the burden of the insolvency without guaranty association protection. Also, the one state in which the insurer is licensed could not alter this result since it is prohibited from assessing any company except for "direct gross peremiums written in this state . . . less return premiums thereto, etc." Increasing the assessment to protect claimants in other states would, therefore, be discriminatory and thus currently impossible.

While the working draft attempts to protect both risk retention group members and consumers in general from the consequences of insolvency, there are obviously needs for further exploration in this area.

Our basic concerns about the House version of the Risk Retention Act were that it would tend to encourage firms to pursue actuarially unsound self-insurance programs merely to gain apparent tax advantages and would place firms with no insurance expertise, skills or disciplines in the business of insurance. Unfortunately, the working draft does not resolve these concerns. The burden of supervision of risk retention groups is put on only one state—the chartering state—even though a group could conceivable do business in all fifty states. With the exception of premium taxes or claims settlement laws, the other forty-nine states would have no jurisdiction over a group. The domiciliary state would find it impossible to monitor the extra-territorial activity of a group. The non-domiciliary state is prohibited under the working draft from regulating directly or indirectly a risk retention group. Thus, serious violations by a group in a nondomiciliary state could not be reported to the home state as this would be an attempt to indirectly regulate.

The broad pre-emption of state regulation contained in the working draft leaves states powerless to protect the legitimate interests of their citizens. The continuous argument is made that certain laws or regulations may hinder the operation of either the "risk retention group" or the "purchasing group", if they seek to conduct operations outside the state in which they are organized.

No one has ever identified specifically what these laws or regulations are except in vague references in testimony by the Department of Commerce proponents. What are these laws or regulations? More importantly, why are they on the books? Don't they serve some purpose? We think the overwhelming majority of these laws and regulations are designed to protect the general public. If so, the working draft quickly pre-empts all such protection without any examination into purpose of the law or regulation which may hinder the operation of groups.

A common example of so-called state impediment is the fictitious group law. Why is such law on the books? A statute prohibiting insurance preference based upon fictitious grouping is directed to the granting of an advantage upon factors other than legitimate rate-making considerations and prohibits preference in rate based upon employment in a particular corporation, but a reduced rate to such a group based upon reduced expense factor is not a prohibited preference (*Caldwell* v. *Standard National Insurance Co.*, 1972, 194 S. E. 2d 456). We would question where this law and case would hinder a risk retention group or a purchasing group and reinforce the need for further study by your Committee.

Other submitted comments have enumerated the range of fundamental state regulatory safeguards pre-empted by this working draft, so we shall not also enumerate them.

We would also repeat the assertion made by others that current state laws, to the best of our knowledge, do not impede the establishment of product liability self-insured groups or group insurance plans. As you know, because of the various allegations concerning perceived state impediments, the National Association of Insurance Commissioners has undertaken the task of identifying and studying these alleged impediments. Any true impediment will be remedied, as the NAIC has made a commitment to rectify the product liability problem. We would urge Congress not to rush to enact legislation which after careful study will prove to be completely unnecessary and ineffective.

NAII appreciates the extensive efforts of your Committee to be fair and reasonable in the consideration of the risk retention concept but would respectfully recommend that further research and exploration be conducted in order to achieve your legislative goals.

Very truly yours,

ARTHUR C. MERTZ, *President.*

NATIONAL ASSOCIATION OF
CASUALTY & SURETY AGENTS,
Washington, D.C., July 25, 1980.

Hon. HOWARD W. CANNON,
Chairman, Senate Commerce Committee,
Washington, D.C.

DEAR CHAIRMAN CANNON: On behalf of the National Association of Casualty and Surety Agents (NACSA), an association representing the medium to large property/casualty insurance agencies and brokerage firms, I would like to thank you for providing us with an opportunity to comment on the staff working draft of the "Product Liability Risk Retention Act." We would appreciate your making these comments a part of the Senate Commerce Committee's hearing record on this Act.

We have reviewed the draft informally with your staff and would like to commend them and you for a more reasonable and realistic approach then either H.R. 6152 or S. 1789.

As you know, NACSA opposed the adoption of the House Bill. We strongly support state regulation of insurance although we recognize it has imperfections. We also believe there is no present need for Federal legislation of this kind which preempts the state regulation mechanism. However, the language of your Committee's working draft removes from the Act a Federal insurance mechanism and eliminates one of our principal objections.

While we sympathize with the posture of many of our clients and recognize the pressure brought for such legislation we, nevertheless, oppose it because we continue to believe that this will not provide the solution, particularly as relates to cost and also the availability of product liability insurance.

Putting aside these concerns, and in an effort to be helpful to the Committee, we would like to bring to your attention our serious reservations about some of the draft's provisions or lack thereof. Briefly, they are as follows:

1. Group membership is left wide open. Membership in a group is not at all defined or restricted. We believe you are assuming that the law of the chartering state will define and/or limit group membership. This may not, however, be a proper assumption to make. Also, with respect to "purchasing groups," any limita-

tions are specifically prohibited by the draft. We find this total lack of limits to be troublesome. Insurance in principle is designed to spread risk among many similar risk exposures. We propose that the wide open membership provisions of the draft be reviewed very carefully.

2. It is very important that the language of the draft on page 3, line 5, "principal activity" and line 9, "primary purpose," be maintained. We believe it should be clearly set forth that the mechanism is not designed for any other lines of insurance. Recognizing that fact, the term, "insurance related services," used on pages 5 and 7 should be defined. The language on page 5, line 12, "or liability insurance." and on page 7, lines 7 and 8, "comprehensive general liability," should be removed.

3. We are concerned that the draft does not make clear what type of state law would be used to charter these groups. Would it be a captive insurance law or exactly what kind of law would the proposed groups use? Should a model chartering law be considered to avoid the disastrous results caused by enactment of weak state insurance laws designed to accommodate such risk retention groups? Unstable group formation could present grave consequences for the group participants (our clients), the consumer, and the public which ultimately pays the price.

4. We are concerned in Section 3 with the non-chartering of offshore insurance mechanisms. Foreign captives should in our judgment come under the safeguards of some regulation for the protection of the client as well as the consumer. We suggest that the foreign captive be required, as are the domestic risk retention groups, to be qualified in at least one state of the U.S.

5. The "Act" was designed to solve the affordability problems of small businesses with respect to product liability insurance. This bill makes no distinction between large and small business in this regard. There has been no demonstrated need for this type of mechanism for large businesses. We suggest an upper limit be established based on amount of annual sales; the Small Business Administration distinguishes between large and small businesses on a similar basis.

6. With respect to Section 4(3), page 6 of the bill, we suggest that the language be clarified in its intent. An insurance agent/broker should be required to be licensed as an agent or broker in the state of residence. We want to prevent unqualified agents and brokers from involvement in such group insurance business. Insurance is by no means a simple business. It is financially sophisticated and should be pursued only by properly qualified agents/brokers.

7. Exemptions in Section 3(b) and Section 4(b) intend to limit the exempted parties to activities of risk retention groups or purchasing groups for product liability and completed operations insurance only. As written, these sections could be more broadly interpreted, giving insurance companies a means of by-passing state regulations in other than these two specific cases for product liability and completed operations insurance.

Briefly, Mr. Chairman, these are NACSA's main concerns and suggestions. If you have any questions or would like any of the above to be further clarified, please do not hesitate to call on us. I trust this will be of help to you, the members of your Committee, and your staff. Again, NACSA appreciates having the opportunity to share its views with you and others on the Senate Commerce Committee.

Yours very truly,

GERALD K. CASSIDY.

MEDIA, PA., *July 30, 1980.*

Hon. HOWARD W. CANNON,
Senate of the United States, Russell Senate Office Building, Washington, D.C.

DEAR SENATOR CANNON: The following comments are being offered relative to the new working draft of the Risk Retention Bill currently before your Committee as S. 1789. I appreciate that the deadline for comment has passed, but am sending these now because I did not receive a copy of this draft until the 17th, and have been traveling much of the time since.

Currently, I serve as Chairman of the Advisory Committee to the Products Liability Task Force of the NAIC, and have, since its inception several years ago. It should be emphasized, however, that reference is made to this only to indicate my background. The comments contained in this letter represent my own views, and are not being made on behalf of the Advisory Committee, although I am not aware of any substantial differences.

It might be helpful, first, to indicate my background. For twenty-seven years, until last September, I was employed as an attorney by INA, specializing in insurance regulation, most recently as Associated General Counsel responsible for government affairs. Because of INA's very active role in this area, I was exposed to, and participated in, many activities relevant to problems here, such as the revisions of numerous state insurance codes and other insurance regulatory laws, the NAIC Advisory Committee on Guaranty Associations (Chairman for several years), Chairman of the Board of the Pennsylvania Insurance Guarantee Association, an active member of the NAIC Advisory Committees dealing with Surplus Lines Insurance, fair trade practices model legislation, and I served for about ten years in effect, as General Counsel, of a surplus lines company. My work required me to deal regularly with the state insurance laws, Insurance Commissioners, and, particularly, with problems relative to fictitious group laws, counter-signature laws, and other areas currently alleged to provide barriers to the organization and operations of Risk Retention groups as licensed insurance companies.

INA was led, for many years, by John Diemand, a man of great ability, courage, and very high principles, who, in my opinion, was the outstanding insurance executive of the Twentieth Century. He was dedicated to the position that the policies of INA must be consistent with the public interest, and this basic policy continued to be effective at INA for many years after his retirement. As a result, my own basic motivation was conditioned, additionally, to seek policy positions supporting the public and consumer interest. Presently, as a consultant, I am not inhibited in any manner, by any policies of positions, other than my own.

In this letter, I'll concentrate on a few major points relative to the consumer, and leave comments relative to insurance companies to others with a more direct interest.

This legislation, since inception, has appeared to be inspired primarily for the purpose of obtaining low cost products liability insurance for manufacturers, primarily smaller manufacturers, in sensitive areas. This is a proper and sound purpose. The proposals to date, however, seem to make clearly secondary, the interests of the public, generally, in relation to the effect on them as potential third party claimants for injuries or loss of property resulting from faulty products.

To me, the latter is the more important concern. The effect on manufacturers, and in turn, the public, of high cost insurance to the extent this is so, is important not only directly, but as reflected in higher costs for products, but the relatively small increases over-all, as a percentage of the articles manufactured, seems clearly secondary to the regulatory protection which should be maintained in favor of the many claimants scattered throughout the United States, and even, for that matter, in favor of the manufacturers who may not understand that they may be prejudiced by a lack of regulation as well. I have been surprised, to a degree, by the support given the legislation by professional consumer advocates, who seem to place the financial interest of the manufacturers before the protection of the financial security of the public.

Turning now to the so-called trade barrier provisions, argued to be present in state regulatory laws which are said to prevent formation of insurers under the state laws, I'd like to point out very briefly why I believe the adverse effects of such laws have been overemphasized all out of proportion by proponents of S. 1789.

INA was, perhaps, the outstanding insurer in the early development of mass merchandising, and so-called group insurance. As an attorney for INA I fought against the adoption fictitious group laws, sought modifications to redeem their impact. While I hold no brief whatsoever for these laws, and seek their repeal, it has been the worst sort of red herring to claim that the laws would furnish a barrier against the sale of products liability insurance, by the equivalent of Risk Retention groups incorporated under state laws as insurers.

There are, literally, hundreds of insurers formed as mutual insurers, reciprocals, and stock companies, to provide insurance for members of groups, associations, members of a profession, members of an occupation, etc. The Church Fire Insurance Company, licensed throughout the United States, and organized as a subsidiary of the Episcopal Church, to write property insurance on Episcopal churches, is an excellent example, as are the many, many insurers organized to write farmers, some conditioned on membership in groups such as Farm Bureaus.

None of these companies, to my knowledge, have been challenged. Furthermore, it should be noted that the basic pattern of the law is to prohibit giving any preference or distinction, based on membership in any group or association of any kind. Such insurers, as would be the case here, would probably not sell insurance to those outside of the group for the same coverage, so there would be no preference or distinction, or if they did, and sold it on the same basis as they did to those within the group, again, there would be no preference or distinction. In short, the laws would not apply, and there are, literally, hundreds of precedents for this conclusion.

As to the countersignature laws, these were trade barrier type laws set up to protect local agents from competition of large agents, and brokers in the insurance centers from operating over state lines. Incidentally, the laws were tested and upheld as being within the authority of the state by the Supreme Court of the

United States in the case of *Osborn* v. *Ozlin*, in 1943, the same year as the SCUA decision, and two years before the McCarran Act, so that they preceded McCarran, and are not a product of regulation under the provisions of that law.

Without spending a lot of time on the subject, it is informative to know how one prominent group of insurers, which are direct writers writing business through salaried employees, handles the problem of the countersignature laws. The Factory Mutuals, a group of independently operated insurers, market their insurance in this manner as direct writers. They also sell insurance through brokers, but the insurance is sold without any allowance for commission, and the broker obtains his compensation from a fee, or commission, charged the insured, not the insurer. Some states have laws requiring a local countersigning agent be paid a commission as high as 50 percent of the normal commission paid. The General Counsel of the Factory Mutuals once pointed out in a public meeting on countersignature, that 50 percent of nothing is nothing. Also, it should be noted, that unlike property insurance, where the various locations of a multistate risk can be allocated by size on a state-by-state basis, and local countersignatures required, no one knows the possible places of exposure for a manufactured product, so that the situs of these policies is a single state, where taxes are paid as well. It is a relatively simple matter to appoint an agent in that state to comply with the laws, who can be an employee of the insurer. The Risk Retention groups would appear likely to be direct writers, who should have little difficulty in following the procedures used by the Factory Mutuals, which for such companies remove impediments, particularly for products liability types of insurance.

Residual market participation, state taxes, and guarantee fund assessments, are regarded by some as barriers out of all proportion to their importance. The only residual market covering products liability would be a few medical malpractice JUA's, which assess on the basis of liability writings, generally. Assessments are de minimus and widely spread, so that the cost to a products liability writer is peanuts. State taxes are small in comparison with sales taxes, which apply in some states to services, and which would probably apply here if the premium tax did not preempt the field. Besides, this bill does not preempt the premium tax area. Guarantee Association assessments are limited to 1 percent in about 50 percent of the states, on annual premiums, and 2 percent in the balance of the states. This is the top limit, and since the total assessment since inception of these associations, in 1969, has been only about one-half of one-tenth of 1 percent on the average, it's clear that the maximum levels of assessment occur on very rare occasions, only, and then in a few states. Assessments are levied only on premiums written in a particular state, not national premiums, which again limits the maximum impact greatly.

On the other hand, what are the disadvantages for the public in preempting virtually all state regulations, as is the case here? Basically, it's important to realize that state regulatory laws, like federal laws, are enacted by conscientious legislators, who are trying to act in the public interest, and, in fact, their authority stems from the police power, which, to me, is another way of phrasing it as "the public interest." Their work product doesn't always achieve this goal, but it is ridiculous to conclude that the state legislators have failed completely, or to such a degree, as to justify nullifying their efforts completely. There are ample areas for selective deregulation, but from the best interest of the public, I look with jaundiced eyes at the great enthusiasm of manufacturers who wish to self-insure and desire to do away with state regulation, and I am more than a little amused by their efforts to avoid the federal government's attempts to fill the regulatory vacuum, particularly by the broad and very vague powers proposed in S. 1789. One wonders if their ultimate concern is the public interest?

Time doesn't permit an overall analysis of the numerous desirable aspects of state regulation, which would be extinguished by the preemption of state regulation in the draft, so I'll review briefly only three areas of particular importance as follows:

a. State Regulation for Solvency by Domiciliary States and as a Condition of Licensing

The obvious efforts by proponents of the Risk Retention Act to avoid the capital and surplus requirements contained in the state laws is important. Generally, the most severe of these require very conservative amounts of capital to write as "risky" a line as products liability insurance, with the chances of such large verdicts. After all, the essential function of the insurer is to provide financial security, not only for the insured, but in the case of liability insurance, to be able to guarantee payment of proper claims by third persons against the insured. I am reminded that INA once used a slogan soon abolished by a chief executive, who quite properly didn't like the gambling connotation but very appropriate in this context. It was "When the chips are down the chips are there." This is a very important truth to keep in mind, particularly when legislators are urged to grant relief from so-called onerous regulatory barriers requiring reasonable amounts of capital and surplus.

In this context, it should be recognized, by permitting the organization of a Risk Retention Group, and even the operations of a commercial insurer, to write the lines of insurance included in the Bill in any state or foreign country, and then operate free from regulation in the balance of the United States, or all of it, if domiciled abroad, reduces the amount of capital and surplus to the lowest required anywhere in the world, which is practically nothing. It's not an exaggeration to point out that wolves assume the disguise of insurers when permitted such freedom, as experience has shown, and fools place their optimism before their responsibility to the public, insurers become insolvent by design, by fraud, and by poor management. Adequate capital and surplus requirements don't prevent this in some cases, but when coupled with continuing regulation and examination, they prevent many unqualified persons from entering the field, and reduce greatly the number of failures. One is reminded of the dangers when one recalls names of Ben Jack Cage, Stewart Hoppes, and Birrell. The regulation for solvency is not perfect, but to preempt it with a vacuum in its place is not in the public interest, and any justification for it should be far stronger than has been demonstrated.

b. State Guarantee Associations

The operations of the state guarantee associations for property and casualty companies, since 1969, and life, and accident, and health guarantee associations in many states more recently, is really a great success story, even though some insurance executives, and others, don't appreciate the fact. Today, all states but Oklahoma have either property and casualty associations, or a state fund (New York), and the public is protected from the catastrophic losses which could result from the insolvency of an insurer, and the resulting loss of insurance.

Associations secure their funds from assessments on licensed insurers, who, in turn, are permitted to recoup payments from proportionally increased rates charged the policyholders of solvent companies. It is most important to keep in mind who ultimately pays this cost because, in essence, it differs little from a tax, and it is in the public interest to provide such protection as economically and efficiently as possible. Total assessments, in the eleven years through 1978, have been about $259,000,000, or, as mentioned, one-half of one-tenth of 1 percent of written premiums, a figure much like the approximately one-half of one-tenth of 1 percent of deposits, which I understand is paid by the banks for deposit insurance. This is really a small amount to pay for such vital financial security.

It is important, in the context of this Bill, to appreciate that all states limit participation in such associations to insurers who are licensed and regulated. There has been criticism of such limitations in the past, at the federal level, by those who perhaps do not appreciate that Federal Deposit Insurance is not provided to banks which do not meet federal standards, and do not submit to regulation. It would seem unfair to me, in both instances, to, in effect, place the cost of covering the losses of such institutions on payments by those banks, and their customers, who abide by the standards, and submit to regulation. The point is important, here, because the language in the Draft which places membership on an optional basis with a guarantee association, is a nullity. As Chairman of the Board of Directors of the Pennsylvania Gurantee Association, I could not recommend admitting insurers operating under this legislation, and free from state regulation, to membership, legally, and even if so, it would be unfair to the members, generally, and to their policyholders who submit to regulation. The net result is that there can, and will, be no guarantee association protection for claimants against insolvent Risk Retention Groups, and insurers operating under this preemption. Such a system is against the public interest, in any event, but it becomes particularly bad in light of the complete lack of any regulation for solvency.

c. Unfair Trade Practices Regulation

State regulation, in the unfair practices area, has improved greatly in recent years. Contrary to the biased GAO study of state insurance regulation, the state complaint system is probably the finest, and most sophisticated, and effective system for handling consumer complaints, currently in place in the United States. This is particularly relevant here because, if state regulation is preempted in this area, the FTC Act would apply. A GAO study, I believe issued on October 17, 1978, pointed out that despite its existence for nearly seventy years, the FTC has no system for handling complaints of individuals, because they are not considered of sufficient importance. By comparison, the state system must have handled well over 500,000 annually, in the years that the GAO examined it.

The NAIC have revised the Model Unfair Trade Practices Act in recent years, adopted a new Model Unfair Claims Practices Regulation based on a new law on this subject, and improved complaint handling, among other things. Many states have taken the initiative to improve their systems, and numerous types of new laws have been recommended, and enacted, in related areas. Your colleague, Senator Durking, was co-Chairman of the Commissioners Committee which revised the Unfair Trade Practices Act, as well as being a member of the Committee which designed the model Guarantee Association Law, and is familiar, personally, with many of these developments.

Consideration of the differences between a state regulation, and a total lack of regulation, or limited federal regulation, and the potential adverse consequences to the public, is brought home, particularly when one considers the the Unfair Trade Practices area. Probably the greatest benefit to the public from state regulation of insurance, is the relatively close relation between the regulator and the concerned citizen. It's not necessarily a criticism of the FTC that they don't have the capacity for handling personal complaints, whereas the Pennsylvania Insurance Department with at least three offices outside of Harrisburg, can handle upwards of 40,000 a year, effectively. It may be the exemption from the preemption for claim settlements will permit some state regulation, but the term is vague, although clearly limited, and I don't see how state regulators can enforce their laws on this subject against Risk Retention Groups, or insurers who are not licensed and regulated, and who probably wouldn't even come under the Service of Process Act.

In summary, the Bill will preempt Risk Retention Groups, and insurers selling products liability insurance, completed performance insurance, and, if it is not an editorial error in Section 3, all kinds of liability insurance, free from any state regulation with the minor and limited exceptions noted. Licensed insurers such as INA, for example, could form an offshore subsidiary, or use an existing one, to write these lines back in the States if it is so desired. A successor to Steward Hoppes, and the International of Tangiers, would have a field day.

If I were a member of Congress, concerned with the public welfare, and appreciated the very real and immediate dangers to the public, and to the consumer, which would follow directly from approval of this legislation, both because of the substance as applied here, and because of the precedent which it creates, I wouldn't support this legislation. I hope that you will not, and that at least a majority of your colleagues will agree.

The chance to comment is appreciated.

Sincerely,

WILLIAM B. PUGH, Jr.

STATEMENT OF NATIONAL ASSOCIATION OF INDEPENDENT INSURERS

The National Association of Independent Insurers (NAII) would like to go on record in opposition to the Product Liability Risk Retention Act. Enactment of this legislation is unnecessary and will not successfully address the insurance affordability problem. Cost savings will remain elusive. The bill will foster unwarranted federal intervention in state regulation of insurance and will lead to the establishment of a dual system of insurance regulation. Passage of this bill also will delay or prevent enactment of tort reform legislation which would provide the most effective solution to the product liability problem.

NAII is a voluntary national trade association of more than 640 insurers.[1] Our organization provides a representative cross-section of the casualty and fire insurance business in America. Our members ranges in size from the smallest one-state companies to the very largest national writers: they comprise both stock and nonstock corporations and reflects all forms of merchandising—independent agency, exclusive agency, and direct writers. They include insurers serving a general market and those that specialize in serving particular consumer groups such as farmers, teachers, government employees, military personnel and truckers.

In early 1976, NAII formed a special committee to both study the product liability problem and attempt to develop potential solutions thereto. Obviously we did not have the tremendous facilities of the Interagency Task Force, but we did arrive at the same basic conclusion in determining the need for tort reform in the product liability system. We recognized that the product liability problem was in reality a socio-economic one, with many ramifications which go beyond the bounds and capabilities of the insurance industry. Focus of various groups, including the insurance industry, manufacturers, legal scholars and now the federal government, has rightfully centered on the tort liability aspects of the problem and various suggestions have been made for modifications of the existing legal structure to mitigate known abuses or shortcomings.

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[1] 458 members and 190 statistical subscribers.

The Final Report of the Interagency Task Force did lay to rest many myths about the apparent crisis in product liability. The Final Report does clearly state that there is no widespread problem of product liability insurance being unavailable. It indicates that for some companies, product liability rates would appear to be unaffordable. As a result, many argue that is a practical equivalent of unavailability. Some manufacturers have thus discontinued products whose potential for harm outweighs their social utility. An attack on the problem of affordability should be the focus of the Committee hearing. NAII would offer its views on the various solutions, including the risk retention bill being mentioned for solving the product liability problem, i.e., affordability.

Both the Final Report and the Department of Commerce's Options Paper (April 6, 1978 43 FR 14612) identify three principal causes of the "problem": insurer rate-making practices; uncertainties in the tort-litigation system; and the manufacture of unsafe products. In addressing each listed cause individually, NAII would grant that the absence of adequate data in the products liability areas had in itself been a serious problem. Many advocates of modification of the current system unfortunately do not recognize recent efforts by the insurance industry and the state regulators to combat this deficiency. The insurance Service Office (ISO) has promulgated a new statistical plan that will produce valuable statistics about product liability. The National Association of Insurance Commissioners (NAIC) has released a comprehensive model state questionnaire for product liability and completed operations. In addition, the NAIC Blanks Committee adopted a supplement for product liability to the annual statement starting this year. The latter is required of each insurer in each state in which it is licensed to do business. The annual statement is a public document in every state. The compilation of data from these sources will eliminate one of the chief complaints of the Task Force Final Report. The availability of such statistical data will have a beneficial effect on premiums due to renewed keen competition in the marketplace.

NAII agrees with the identification of the problem of unsafe manufacturing practices. In recent years, the federal government has become involved in some aspects in the product safety area through the enactment and implementation of the Consumer Products Safety Act, the Flammable Fabrics Act, the National Highway Safety and Transportation Act, and the Occupational Safety and Health Act. Such measures are designed to effectively promote product and occupational safety as one fundamental method of alleviating the underlying causes of the product liability "affordability" concern. NAII would agree that stronger safety measures would diminish injuries from product-related accidents and help stabilize the costs of product liability coverage. The original proposal, in the Department of Commerce's Option Paper, to develop a specific federal government program of sharing product risk information with private industry was one NAII felt should be further explored. Experience developed from the medical malpractice crisis of a few years ago strongly indicates that risk management programs and loss prevention awareness have played a key role in reducing that problem. Again, competition returning to the product liability marketplace may lead to the encouragement of effective loss prevention plans on behalf of small business with the aid of the insurers or their trade association. We would fully support further inquiry into the development of technical assistant programs.

The Administration has proposed two remedies for a resolution of the product liability problem—the Product Liability Risk Retention Act and the Model Uniform Product Liability Law.

NAII is on record in accord with the conclusions reached by the Federal Interagency Task Force Final Report on the impact resulting from the uncertainties in the tort-litigation system. There is clear evidence that there is a marked increase in exposure to liability. There can be no doubt that there is a need to restore a balance in the states' tort liability reparations system. NAII believes that it is the role of the individual states to weigh the merits of various tort reform proposals to ensure a proper balance between the rights of claimants to recover for product-related injuries and the rights of manufacturers to be free from unreasonable product liability awards. In the area of improvement of the tort-litigation system, the arguments advanced in the Department of Commerce's Options Paper on both sides of the issue of federal intervention are clearly persuasive that the states should be allowed to act. Any attempts at federal preemption in this area will create further uncertainties in the system. The tremendous burden that would be placed on the Federal Court System conflicts with current efforts to decrease the backlog of cases now before these courts. Insurers and companies even with only partial preemption, would be caught in a maze of perhaps duplicate state and federal lawsuits.

The NAII Board of Governors in November 1976 adopted a Resolution strongl supporting reforms in the tort liability system as the most effective solution to th product liability problem. We commend the Task Force headed by Professor Victc Schwartz for its insistence that the Model Uniform Product Liability Act is for stat implementation rather than opting for preempting federal legislation. Our Assoc ation is in general agreement with the reforms advanced. We feel that the suppor of this Administration for tort legislation should demonstrate that such reform i not solely the goal of the insurance industry but does represent the considere needs of impartial interests.

Since its founding in 1945, NAII has been dedicated to fostering healthy competi tion in rates, coverages and services under sound state regulation. The Associatior has played a leading role in broadening the channels of competition under the state casualty/property regulatory laws in the post-McCarran Act period, and its membei companies have provided a major share of the rate competition and product and marketing innovations under those laws. The record of more than thirty years of healthy competition and continued growth by our industry under state regulation dictates that we must oppose any unwarranted federal intervention in the regulation of insurance, such as that which would result from the Risk Retention Act.

Many of the NAII member companies were formed as a result of dissatisfaction with insurance market conditions, i.e., Farm Bureau companies, Motor Clubs, companies offering coverage exclusively to the military, etc. Vigorous competition in pricing has been matched by equally aggressive competition and innovation in products and services. Coverages and the packaging of coverages in both the personal lines and commercial fields have been continuously broadened and improved as companies have vied to better meet the changing demands of the consumer. Companies and producers are likewise constantly vying to find better ways to serve the special needs of particular "publics", and thereby increase their market shares.

All these characteristics typify a highly competitive industry.

Another classical economic measure is market concentration. Property/casualty insurance is one of the few industries which can truly be labeled "atomistic". There are more than 2,900 licensed property/casualty insurers in the United States. Although many do business in only one state, about 900 operate in all or several states.

Numerous studies have documented that the concentration ratio in our business is quite low as compared to most other industries. The largest writer of property/casualty insurance in the country, State Farm, has less than 7 percent of the market for those lines, and the top 20 groups account for less than 54 percent of the market.

Ease of entry by new entrepreneurs is also recognized by economists as a key element in existence and maintenance of a competitive market. Here again, numerous studies agree that entry into property/casualty insurance market has been relatively easy, that there has been a healthy influx of new companies in recent decades (353 new companies entered the market between 1967 and 1976), and that those periods when the influx has slowed are attributable to drops in profitability rather than to entry barriers.

Still another test of competitiveness is profitability. If overall profits were found to be inordinately high, it could indicate that there has been a dearth of competition which has permitted maintenance of artificially high price levels. Exactly the opposite is the case here: The profit record of property/casualty companies as a whole, when measured by formulae applied by recognized economists, has remained well below that of other industries in our economy, reflecting in large part the impact of competition.

In spite of below-par earnings, our industry has managed to provide the increased capacity required to meet the expanding insurance needs of a rapidly growing population and exploding economy. This fact denotes that our business is not only competitive and progressive but highly efficient as well.

Where there have been problems, the states have quickly responded to the challenge with new and innovative regulatory approaches to assure a proper solution for the public but retain a viable industry for the future. When, for example, the medical malpractice problem surfaced, improvements in the tort/insurance system were developed and put into practice almost immediately. The same damage award spiral has created availability pressures in product liability and other professional liability lines that state regulators and the insurance industry have again responded to with direct and practical measures.

Although the possiblity to form groups has existed, it has not been taken advantage of in this line because the product liability market is competitive and because the cost advantages espoused by the drafters of this Act would not be borne out when tested against actual experience. One of the alleged major purposes of the

Risk Retention Act would be to reduce insurance costs for small businesses. We frankly question whether this system would result in any cost savings. The Act as drafted provides that it is intended to be self-supporting. Individual group members will pay the administrative costs involved for the supervision by the Department of Commerce. In addition, it is suggested that many risk retention groups would either hire their own staffs or retain consultants to perform professional underwriting, claims-handling and claims-defense functions. The concept requires a loss prevention program be established which would involve a separate expense. The Department of Commerce apparently would also be authorized to require a risk retention group to limit the maximum amount of risk it retains by obtaining reinsurance or excess coverage. One thus must realistically question the cost savings involved in a risk retention group as compared to purchase of primary product liability coverage. One becomes even more skeptical if the group does not qualify to meet the Internal Revenue Service test of insurance and be unable to avail themselves of this favorable tax treatment. In addition, the provision of the Act subjects the risk retention groups to state insurance premium taxes, not paid presently by individual non-insurance companies.

Among our other concerns are the following:

(1) The Act would assign administration of the program to the Department of Commerce. The absence of insurance expertise or experience in this department or, for that matter, any other department of the Executive Branch, to comprehensively administer, in effect, hundreds of small insurance companies, would be a severe liability. The Act calls for supervision over the amount and liquidity of the assets of the potential member of a group relative to the risks to be assumed and retained by the member applicants; consideration of an applicant's reserves to determine if they are reasonable and adequate to meet expected losses and loss adjustment expenses; determination whether excess insurance is required; a decision on the adequacy of a loss prevention program; review of the adequacy and quality of management of the group; and analyze annual reports which include a statement of financial condition and operations of a risk retention group. NAII does not believe any executive department could assume this responsibility without building a new governmental bureaucracy. The creation of an adequate vehicle to administer a countrywide system of risk groups is in direct conflict with the overwhelming public opposition to "more government and more taxes" philosophy inherent in Proposition 13.

(2) While first proposing a federal guaranty fund, the drafters have now abandoned this concept and are now advancing the proposition that the Act would not prohibit approved risk retention groups from voluntarily joining a state insurance guaranty association. This new position directly contradicts their previous "Options Paper on Guaranty Funds". In that document, the drafters flatly stated that, because approved groups have been exempted from state insurance regulation by the Act, they "will not be protected by state insolvency funds." The same Options Paper pointed out only admitted carriers are covered by the state guaranty funds. Under state law in the majority of states, if not all, the risk retention group would not qualify as a member of a state guaranty fund. It is not a question that the Risk Retention Act does not prohibit a group from joining such a fund but it is the state law that would govern. The drafters want to eliminate state regulation and then attempt to utilize a protection through the back door by having such a group join a state guaranty fund which is subject to state regulation.

Absent also are the concerns by the drafters that a federal fund would provide protection to persons injured by defective products sold by participants in an approved risk retention group in the event the group became insolvent. Now no solution is offered for this previously expressed concern, perhaps in an effort to obtain approval from certain departments of the Administration, when some apparent objections were raised to a federal fund.

(3) The intent of the drafters of the risk retention concept is to limit the Act to product liability and completed operations. This is based on the reasoning that these lines of coverage have unique interstate aspects as opposed to other lines. However, this uniqueness does extend to other lines—long-haul trucking, contractual liability, fidelity and security, and some general liability. If this Act is enacted, the confinement of the risk retention groups to a specific line of coverage may be difficult.

At the hearings held in September 1978 by the House Subcommittee on Miscellaneous-Revenue Measures, a tax deduction for businesses which set aside a portion of their gross income to fund a specific trust or reserve for product liability claims was debated. It is interesting to note that many of the witnesses at this hearing urged similar relief for medical malpractice, legal malpractice and other lines of professional liability such as engineers and architects. It is not unreasonable to believe that once this Act is enacted, there will be a similar movement to expand the coverages to be included in the group. This would put the Federal Government fully in the insurance business and in competition with a viable private industry.

Our basic concerns are that the Risk Retention Act would tend to encourage firms to pursue actuarially unsound self-insurance programs merely to gain apparent tax advantages and would place firms with no insurance expertise, skills or disciplines in the business of insurance. In addition, we feel the concepts embodied in the Act would not be beneficial in alleviating any affordability and/or availability that may exist and, in fact, may actually delay and/or prevent enactment of necessary tort reform legislation which is the only effective approach. Indeed, the Task Force found that the use of deductibles was decreasing for small businesses while it has increased for big business. Self-insurance is by no means a panacea for product liability insurance problems. A major benefit of conventional insurance is its risk distribution aspect. A self-insuring business group, even one which is able to build up reserves with pre-tax dollars, may still be wiped out if the type of liability which may occur once every five years in one of a hundred businesses occurs in year one of its operation. It is probable that the small firms which are presently experiencing premium increases are the same firms where claims are most severe and consequently legal expenses will be higher. Those small firms which have difficulty affording insurance tend to engage in high hazard businesses, businesses where insurance related expenses will be higher than average (Interagency Task Force Report VII-138).

We again seriously question whether business firms would ever utilize the Risk Retention Act in view of the extremely stringent regulatory requirements for a risk retention group/Mr. C. L. Haslam, General Counsel, Department of Commerce, before the House Subcommittee on Consumer Protection and Finance, on October 25, 1979, stated that the Act would achieve its goals without increasing government regulation. He indicated the Act reduces regulation and merely permits businesses to form risk retention groups or to purchase commercial insurance on a group basis. In the same statement, he then twice proceeds to state that the groups will be subject to similar and, in some cases more stringent, requirements as those which commercial insurers must meet.

This is apparently meant to counter the argument that allowing risk retention groups to operate outside state regulation would thereby avoid regulatory safeguards not in the public interest. We would agree that government regulation is needed to no lesser degree in connection with special interest groups. The main intent of government regulation is to safeguard the interest of the public and it is appropriate for any entity engaged in the business of insurance. Insurance departments are already promulgating rules and regulations to control insurance operations. The Act provides the Secretary of Commerce shall promulgate rules and regulations. This is a duplication of effort; why not let the states handle this regulation if the program is desirable? The Act is an attempt to get around state requirements which have been put in place to protect the public against insolvencies and improper practices and by insurers and others. Such state restrictions are even more important for such self-insured groups than they are for commercial insurers if the public is to be protected—especially when you consider that these groups do not have to participate in any guaranty fund law, state or federal. Federal employees will be regulating the operation of the risk retention groups who would be providing a risk sharing function for their members which is a clear intrusion of the federal government into the regulation of the business of insurance. This is an overt attempt to modify the McCarran-Ferguson Act without intense study of the overall effects. In addition, the standards promulgated by the Commerce Department would have to be structured so as not to run afoul of existing federal antitrust statutes. We find it difficult to believe that our free enterprise businesses would consent to further federal bureaucratic regulation.

The Risk Retention Act in actual effect will substantially establish a dual system of regulation of the insurance mechanism. This Act will not promote competition but will invite the destruction of competition in the product liability insurance business through the skimming off of some of the best risks from the existing marketplace, leaving only those risks with high loss experiences. The consumer will be deprived of many regulatory safeguards, rights and remedies they now enjoy under state law, and the Act will weaken overall regulatory effectiveness. We sincerely believe that the concept created by the proposed Act will be unduly costly, wasteful and inefficient.

NAII thus would urge caution by the Committee regarding the espousal of any specific federal program for product liability.

Statement by the Conference of Insurance Legislators

Mr. Chairman, members of the Committee, this statement is submitted on behalf of the Conference of Insurance Legislators (COIL), a voluntary association of the States, consisting of the members of the insurance or insurance-related committees of the State Legislatures. As the Committee is no doubt aware, insurance is the largest private business regulated by the States, and therefore over the years members of the legislatures have developed particular expertise and skills in the business of insurance, and the consumption of insurance.

No other level of government deals so intimately and so continuously with the business of insurance, nor is so aware of the concerns of the consumer of insurance. In almost every state, hundreds of bills concerning insurance are introduced every year; in addition to which many legislatures undertake various forms of oversight of the insurance regulatory function.

It is this experience and background in the business of insurance, and the consumption of insurance, that the Conference wishes to share with members of the Committee in relation to the Product Liability Risk Retention Act of 1980 (PLRRA).

In general the Conference associates itself with the statement of May 21, 1980, by the National Association of Insurance Commissioners (NAIC). That statement provides a detailed analysis of the background of the product liability concern, the ratemaking procedures involved, and the market conditions which have brought us to the present position. The NAIC statement of May 21 provides clear and cogent arguments regarding the ineffectiveness of the PLRRA and the failures that may be expected upon its passage. COIL associates itself with those arguments.

However, beyond the case in opposition made by the NAIC, COIL wishes to express its opposition to the act springing from COIL's legislative background. The NAIC logically approaches the problem from the viewpoint of regulators; COIL wishes to make an additional approach from the viewpoint of legislators.

In this connection COIL particularly wishes to register its objection to the contention by the Department of Commerce that 45 states have by regulation, statute or ruling set up obstacles to the group purchase of insurance. Based on this finding, the Department proposes, through this bill, to override state law and in effect give federal sanction to the formation of any group "which has as one of its purposes the purchase of product liability or completed operations liability insurance on a group basis."

COIL objects to this legislation for three reasons: (1) it is based on fallacious reasoning; (2) it provides inadequate protection for the consumer and the public interest, and (3) it clearly is in conflict with the doctrine of the McCarran-Ferguson Act which reserves to the States the regulation of the "business of insurance."

The first objection is to the logic of the Title establishing risk retention groups. The Department of Commerce finding that 45 states have regulatory or statutory obstacles to the sale of group product liability is based on the laws and rulings established in the 1950s to discourage the mass marketing of automobile insurance, characterized then and now as prohibitions upon the establishment of "fictitious fleets" of automobiles.

For at least the past ten years these statutes and regulations have been subject to modification, repeal and re-interpretation, and research by the NAIC indicates quite clearly that most of these statutes or rules are now either permissive in nature, relate only to personal lines coverages, or have been completely superseded. Insurance commissioners have shown a marked inclination toward a favorable interpretation of rules regarding mass marketed property and casualty insurance. Product liability coverage on a group basis, sold to industry trade associations, would undoubtedly be "interpreted out" of the unfair discrimination basis upon which the original fictitious group ban was founded.

COIL stands ready to use its influence to see that manufacturers and businesses have the opportunity to purchase group product liability coverage in a properly supervised environment. COIL believes that the proper remedy for restrictive state law in this case, which we believe exists in only a few jurisdictions, is to repeal or amend the law, not mandate a federal preemption.

COIL feels the Department of Commerce does an injustice to the argument by claiming that 45 states through statute or regulation make the group purchase of product liability impossible. Such rhetoric fails to illuminate the problem.

Secondly, COIL feels the proposed legislation provided insufficient protection to the consumer and the taxpayer, and therefore is not in the public interest. This concern arises chiefly from the failure of the bill to provide for specific capital and surplus requirements, and its total silence on the subject of guaranty fund mechanisms. Legislators know from experience that insolvency is an ever-present risk in the insurance business, and that one of the functions of government is to establish the kinds of capital and surplus that will mitigate against insolvency, and to provide for the kinds of risk-sharing mechanisms that come into operation in tense financial situations. Virtually every state in the nation has some kind of guaranty fund mechanism as a safety valve to protect against insolvencies; to simply say, as the Department of Commerce argues in this bill, that the Secretary of Commerce will see that risk retention groups are properly capitalized and managed, is not sufficient in our experience.

Thirdly, COIL feels quite strongly that the bill violates the doctrine of state regulation contained in the McCarran-Ferguson Act and consistently reaffirmed since.

Tortuous reasoning is utilized by the Department of Commerce in arguing that risk retention groups are outside the scope of state regulation. Quite simply, the aim of the McCarran-Ferguson Act was, and is, to make it clear that the "business of insurance" is a matter for state regulation and outside some of the antitrust provisions that apply to other interstate businesses. The antitrust exemptions are granted expressly on the grounds that state regulations will protect the public interest, and it is the quality as well as the quantity of that regulation with which insurance legislation is constantly concerned.

There can be no agument but that the risk retention groups envisioned by the bill are engaged in the business of insurance.

To claim that they are "unique" and deserve different regulatory treatment is to show a lack of understanding of insurance regulation.

The Department of Commerce cites the ERISA Act and the Health Maintenance Organization Act as precedent for preempting state insurance regulation; neither is appropriate. ERISA deals with employee benefit plans, which in no way can be described as risk-sharing mechanisms. They are, in fact, trusts. The HMO Act preempts state law only to the extent that such organizations might be prohibited from qualifying for federal grants, and the preemption is narrow, indeed, relating to state requirements for capital, surplus and reserves.

The Conference of Insurance Legislators is solidly on record through its membership as opposing any federal action "which would supersede or contravene the continued regulation and taxation of the business of insurance by the several states" (Policy Statement No. 2, November 4, 1979) and thus must oppose the Product Liability Risk retention Act on these grounds, among others.

The Conference does not in any way mean to intimate that problems in the availability and affordability of product liability insurance have not existed. The Conference believes, however, that the free market mechanisms of the insurance industry, regulated by the states with access to the state legislative process, have already acted to mitigate against the kind of drastic treatment proposed in the PLRRA. The Conference associates itself with the statement made on April 23, 1980, before the House Commerce subcommittee by Homer E. Moyer, general counsel of the Department of Commerce, discussing the issue of federal tort law enactments:

"We believe the states are the appropriate forum to address the growing uncertainities and occasional imbalances that have become a part of the product liability tort litigation system."

Mr. Chairman, the Conference of Insurance Legislators respectfully requests that this Act, the Product Liability Risk Retention Act of 1980, not be approved for passage by this Committee.

Statement of Barry B. Schweig, Ph. D., C.P.C.U., C.L.U., Assistant Professor of Insurance and Finance, College of Business Administration, University of Nebraska-Lincoln

AN ASSESSMENT OF THE FEASIBILITY OF PROMOTING COMPETITION AMONG PROVIDERS OF PRODUCT LIABILITY INSURANCE VIA THE RISK RETENTION ACT OF 1980

The purpose of this paper is to assess the feasibility of promoting competition among providers of products liability insurance via the provisions contained in the Risk Retention Act of 1980. A careful reading of the Act reveals that the only mechanism which promotes competition among insurers is the concept of purchasing products liability and completed operations insurance on a group basis. Hence, an implicit argument is made that an amalgam of once individual firms suddenly become more desirable prospects for insurance when viewed as a group, as opposed to individual applicants, in so far as a products liability insurance underwriter is concerned.

Does this argument hold? From the viewpoint of the authors of the Act, common sense dictated that selling insurance to a group involves economies of scale, and therefore a group approach ought to make products liability and completed operations applicants more desirable, and therefore increased competition for their insurance would likely result. Unfortunately, this may not be the case. In fact, on the basis of my investigations into various facets of the products liability problem, a group underwriting approach may have the opposite effect—i.e., the lack of competition among insurers may be exacerbated rather than improved.

Let me first present an analysis of the factors which enter into the products liability insurance underwriting decision process. Then I will argue that compared to relying upon group insurance at least one other approach to promoting competition among providers of products liability insurance may have a greater likelihood of success.

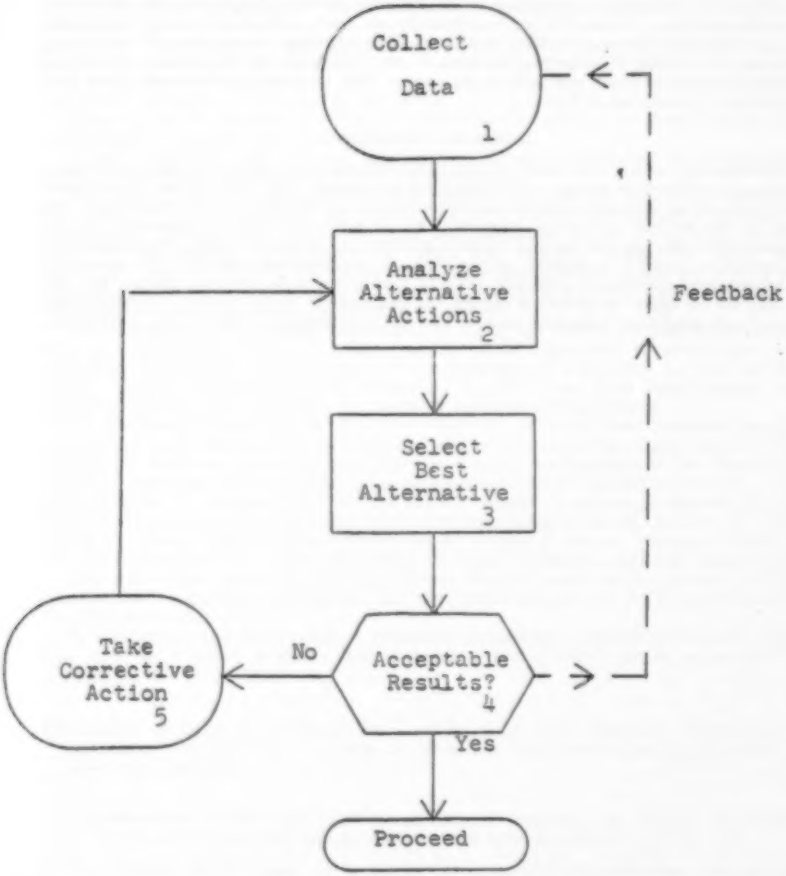
Since products liability underwriting is a formal decision-making procedure, the underwriting process is amenable to analysis by decomposition into the more elemental and distinct steps found in virtually all formal decision-making processes. These steps may be summarized as follows: (1) gathering information, (2) analyzing alternative actions, (3) selecting the best action, (4) monitoring the results, (5) taking corrective action when and where necessary. The relationship between these five elements is presented in Figure 1.

GATHERING INFORMATION

Information which is utilized in the underwriting or products liability insurance is usually difficult to obtain and often quite expensive. The underwriter must ferret out as much of this information as possible while at the same time minimizing the cost to his or her insurance company. An underwriter must of necessity be an expert in combining precise and reliable information with his or her own experience in order to produce successful and profitable underwriting results. The generally acknowledged sources of products liability insurance underwriting information are as follows: (a) agent or broker of record, (b) confidential credit report, (c) engineering report, (d) product's technical report, and (e) confidential underwriting guidelines.

FIGURE 1

OUTLINE OF THE DECISION-MAKING PROCESS


Collect Data 1
Analyze Alternative Actions 2
Select Best Alternative 3
Acceptable Results? 4
Take Corrective Action 5
No
Yes
Proceed
Feedback

Source: George L. Head, "Underwriting in Five Easy Lessons?" The Journal of Risk and Insurance, Volume 35, No. 2, (1968), pp. 308-310.

Agent or broker of record

Most property-casualty producers are hard pressed to survive commercially in today's marketplace. The large national brokerage firms threaten to acquire their commercial accounts while the direct writers compete vigorously in their personal lines markets. In order to survive, most agencies have had to abandon their undifferentiated approach to selling insurance and to divide or segment their market.

Insurance market segmentation is often based upon the approachability of particular types of customers. For example, customers may be segmented by location, size, product manufactured, or any number of other considerations. Market segmentation also can be used profitably by the astute products liability insurance underwriter. By becoming familiar with the record of prior submissions of a particular agent or broker, the underwriter can frequently eliminate additional underwriting effort and expense by recognizing the agent of record as one who solicits business which the insurer does not wish to insure.

Confidential credit report

An important additional source of information which the underwriter will often utilize is the confidential credit report. Before an underwriter agrees to issue products liability insurance, he or she may find it expedient to obtain a Dun and Bradstreet credit report. This kind of report can be invaluable.

The management of a firm, for example, which finds itself in financial difficulty may attempt to minimize production costs by skimping on quality control procedures. Management may in fact believe that allowing defective products to be entered into the "stream of commerce" may be preferable to withholding the goods and watching the firm fail financially. Anyone who is acquainted with the Arthur Miller drama, "All My sons," can vouch for the hazards involved with individuals who think more of profit than of the (product) safety of others.[1]

In addition to a credit report, the underwriter may request background verification of product knowledge and managerial skills among the firm's managers or owners. The confidential credit report and other investigative reports which deal with the attributes of the firm contain vital underwiting information on the presence of possible moral and morale hazards in the firm. These reports are reliable and frequently utilized. Yet, they reveal only one-half of the picture. Still lacking is information concerning the physical hazards presented by the risk.

Engineering report

The engineering report is a formal written summary of the observations of an insurance company loss control specialist who visits the premises of the applicant for insurance. The loss control engineer is charged with the responsibility of verifying all of the underwriting information included on the application for coverage as well as providing an accurate description of the plant, the employees, and the general business operations of the firm.

The loss control engineer also may devote a considerable portion of time to the development of a set of specific loss prevention recommendations. These recommendations are derived from an analysis of the firm's exposure to pure loss as well as the firm's attitudes toward losses and loss prevention activities.

Products' technical report

A products' technical report contains the following kinds of products' loss control information: (1) loss control programs, (2) accident and complaint reporting and investigations procedures, (3) design, labelling and packaging standards, (4) quality control procedures, (5) marketing and sales standards, (6) employees and managers, and (7) produce servicing.

Since a firm's loss control records and program are often the most reliable indicators of the firm's success or failure in the defense of a potentially devastating products' law suit, the loss control specialist will begin by checking that the product has been produced, packaged and shipped properly. The firm's accident, complaint reporting and investigations procedures will then be studied because the lack of support for these kinds of procedures by top management can greatly magnify the products' hazard. The loss control specialist will also be interested in the firm's product recall or product modifications' programs, because of the potential for catastrophic product's losses. The marketing and sales practices of the firm represent additional areas of concern to the loss control specialist. Some employees and foremen of the firm will be interviewed also, to detect any labor-management difficulties, high turnover rates among hourly employees, or any other kinds of personnel problems which could affect the products risk. Finally, the lost control specialist makes an overall recommendation as to the underwriting opinion which ought to be rendered in the case.

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[1] Dramatic action in this Arthur Miller play revolves around the culpability for shipment of defective engine parts for American fighter aircraft in World War II. The defective parts result in the death of many fighter pilots and also ultimately destroy the factory owner who chooses to ship the parts, knowing them to be defective, rather than allowing the military authorities to close his factory and bankrupt him.

Confidential underwiting guidelines

Confidential underwriting guidelines represent the insurance company's total accumulated proprietary underwriting and ratemaking information. These guidelines are thought to represent the insurance company's competitive underwriting advantage and are, therefore, jealously guarded and secretly maintained. The most critical role of these confidential guidelines are as cues to help the underwriter make the kinds of decisions which best serve the multiple underwriting objectives of his or her respective insurance company.

ANALYZING ALTERNATIVE ACTIONS

Once the underwriting information gathering has been completed, the underwriter will begin analyzing the alternative actions which are available. The underwriter in a products liability case generally must choose between the following four underwriting decision alternatives: (1) reject, (2) accept-conditionally, (3) accept-tentatively, (4) accept.

If the underwriter decides to reject the risk at this point, he or she is in effect saying that nothing can be done to rehabilitate the applicant or his firm. Alternatively, the underwriter may decide that according to the information provided, the risk is not acceptable as submitted, but there is still the possibility that an alternative to a reject decision may be found, such as acceptance at a higher premium rate. The underwriter will, therefore, consider an accept-conditionally decision whenever the possibility of a counter-offer or a conditional acceptance seems appropriate. The decision to accept-tentatively will be made whenever the applicant and the firm appear to be acceptable, but additional information and evaluation are necessary before a final underwriting decision can be made. The accept decision implies that the applicant and the firm are both acceptable and that no further information nor evaluation need be made.

In general, the amount of analysis which is devoted to each individual underwriting case will vary depending upon the complextiy of the case, the amount of time available to reach a decision, and the case load of the products liability underwriter.

SELECTING THE BEST ACTION

The choice of the best action from among the available alternatives is at the heart of the products liability underwriting decision process. Although the underwriter is often depicted as being untrammeled in his decision-making, this view is not entirely correct. In the majority of underwriting decisions, one or more of the following constraints may chafe the underwriter: (1) reinsurance treaties, (2) entire account underwriting, (3) premium rate determinations, or (4) competitive considerations.

Reinsurance treaties

When an insurance company reinsures any portion of a risk, or the entire risk, it is essentially buying security, and as such will have to pay a price for this protection. The insurance company then will forego a portion of its expected profits in order to reduce the possibility of debilitating losses. However, it should be emphasized that reinsurance is not a hedge against poor underwriting or underwriting losses; since no amount of reinsurance can transform "bad" business into "good" business. If the risk should have been declined, but instead was written, the primary insurer usually ends up paying for it anyway.[2]

Fortunately, underwriters are able to arrange for adequate reinsurance on the majority of their cases. In the rare instances where reinsurer refusal has created stumbling blocks to a completed insurance transaction, the underwriter could well reason that the reinsurer may have made a more accurate assessment of the situation; and that assessment might well spare the underwriter additional problems for the future.

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[2] For example, under an experience refund agreement between the primary insurer and the reinsurer, profitable experience is rewarded with a refund of reinsurance premiums previously paid, and poor experience may lead to ever increasing reinsurance premiums. Most reinsurance treaties include some provision for adjusting costs on the basis of ultimate profitability to the reinsurer.

Entire account underwriting

Entire account underwriting, or collateral lines considerations, refers to the underwriter's agreement to provide a high risk coverage live products liability only if the firm's entire package of insurance is available as well.

Premium rate determinations

Products liability insurance premium rate determinations may be made by employing one or more of the following ratemaking techniques: (1) manual or classification ratemaking, (2) merit ratemaking, or (3) judgment ratemaking. Manual or classification ratemaking involes the classification of applicants for products liability insurance coverage into one of many distinct rate groups according to some easily discernable hazard characteristics.

The primary advantage of the manual or classification ratemaking technique is that once the rate for each group has been actuarially determined, all the insureds in the same rate group are charged the identical rate. Therefore, assuming that each applicant for product liability insurance can be correctly assigned to an appropriate rate group, it is a simple matter to open the rate manual to the proper page and read the rate to be charged each applicants for products liability insurance directly from the manual (hence the term, manual rating). Although the pure premium method of manual or classification ratemaking is in fact the ratemaking technique used by the Insuance Service Office, the single ratemaking bureau for all products liability risks in the United States, less than two-thirds of all products' risk have rates assigned to them. The balance of the rating classifications fall into the unrated, or a-rated categories. For example, all toys, optical goods, chemicals, and mobile homes are a-rated products.

Merit ratemaking is an addition premium computational technique, designed to evaluate the insured as an individual risk. The price paid for coverage under merit rating plans reflects more fully the experience of the particular insured, rather than the experience of an entire group of insureds as would be the case with manual or classification ratemaking.

There are four varieties of merit or individual-insured rating plans as follows: (1) rating classes, (2) schedule rating, (3) prospective rating, and (4) retrospective rating. Special rating classes may be established to enable the products liability insurance underwriter to deviate from promulgated manual rates or to establish separate rating categories which may share in special dividend distributions at the end of the policy period.

Schedule rating, which evolved from the debits and credits applied to fire insurance ratemaking, can also be applied to products liability insurance rates. Explicit recognition is given to the premium rate charged to the applicant for positive pre-loss prevention and post-loss minimization expenditures. For example, a manufacturer which agrees to additional safeguards in the testing and production of the firm's products may qualify for a reduction from the manual rate.

Prospective experience rating plans are designed to adjust the rate which the insured will pay in the future, based upon the insured's actual incurred losses over a period in the past (usually three years), ending one year before the effective date of the contract. Prospective experience rating plans look to the past, but rate adjustments are made in future periods only.

A further refinement in experience rating of individual-insureds is the use of retrospective experience ratemaking. These plans involve an adjustment of the insured's premium at the end of the policy period on the basis of the losses incurred during the period. Retrospectively rated plans may be used in conjunction with prospectively rated plans as well as with manually rated plans. Retrospectively rated plans are becoming more popular and more widely used because they provide for a more rapid adjustment to changing loss and expense trends when compared to prospectively or manually rated plans.

Competitive considerations

Whenever two or more insurance companies begin to compete for the right to insure the identical risk, underwriter objectivity may suffer. The applicant as well as the submitting agent or broker may simultaneously pressure the underwriter to accept the products exposure on terms which are less than favorable to the insurance company.

MONITORING THE RESULTS

The products liability underwriter may monitor the results of previous decisions by reviewing all submitted claims, and by various follow-up reports generated by his or her own insurance company's auditing and inspection departments. Although these procedures may be useful to some extent, the fact that it may take many years for any defective products to surface in the form of a claim, or a law suit to be defended, tends to insulate the underwriter somewhat from their recent decisions. Any reliable or meaningful assessment of a products liability underwriter's decisions is further muddled by the dilemma of "good" underwriting decisions which result in bad outcomes versus "bad" underwriting decisions which result in good outcomes. The situation is analogous to a novice gambler who makes all the "wrong" bets but nevertheless wins, while the more experienced brethren make only the "right" bets, but lose.

TAKING CORRECTIVE ACTION

The underwriter will normally make corrections in regard to a previous underwriting decision during the periodic re-underwriting of insureds. The underwriter may institute a premium increase, or insist upon additional restrictive policy conditions, or in extreme cases the coverage may be terminated prior to the end of the policy term.

UNDERWRITING INFORMATION: THE KEY TO PROMOTING COMPETITION AMONG PROVIDERS OF PRODUCTS LIABILITY INSURANCE

Note that products liability and completed operations insurance is extremely difficult to underwrite. Because of the catastrophic loss potential, underwriters must expend tremendous amounts of time, energy and money in order to satisfy themselves that the applicant for insurance ought to be accepted at an affordable premium rate. Yet there are no provisions in the Risk Retention that compell—or even suggest—that information is a necessary or important key to successful products liability underwriting.

I believe that the Risk Retention Act ought to be amended to include mandatory disclosure of all products liability exposures presented by each of the firms seeking coverage under the provisions of the Act. Moreover, the Commerce Department should be instructed to develop suitable products liability and completed operations risk analysis questionnaires for use by businesspersons and underwriters under this Act. Such an approach—one that aids the individual underwriter by standardizing the information necessary for him or her to reach an appropriate underwriting—is a necessary requisite in any plan to promote competition among providers of products liability and completed operations insurance.

Thank you for the opportunity to express my personal views on this most timely and important topic.

STATEMENT OF THE SOCIETY OF THE PLASTICS INDUSTRY, INC.

This statement is submitted on behalf of The Society of the Plastics Industry, Inc. in support of S. 1789, the Product Liability Risk Retention Act.

The Society of the Plastics Industry, Inc. (SPI) is the major national trade association for the plastics industry, its membership representing an estimated 75 percent of the total volume of plastics sales in the United States. SPI is composed of approximately 1,300 member companies and individuals who supply raw materials, process or manufacture plastics or plastics products, engineer or construct molds or similar accessory equipment for the plastics industry, and engage in the manufacture of machinery used to make plastics products and materials of all types. The majority of SPI members are small businesses.

SPI has been actively engaged in the efforts to restore equity and fairness to the products liability tort system. To this end, it supports adoption of the U.S. Department of Commerce Uniform Product Liability Act (the so-called "Model Act") by the individual states. Adoption of the Model Act would, we believe, provide a basis for the reduction of product liability insurance premium rates.

Nevertheless, SPI is of the opinion that manufacturers, particularly small manufacturers, should have the right to form their own insurance pools or to bargain collectively with insurance carriers as S. 1789 would provide. Recent surveys disclose that small manufacturers cannot easily afford product liability insurance and, in some cases, are unable to purchase insurance at all. As a consequence, some of them have become self-insurers open to the risk of bankruptcy on the basis of a single adverse judgment.

Under these circumstances, SPI believes that increasing the option for products liability insurance coverage is necessary and desirable. Indeed, even the potential to form insurance pools or to bargain collectively for more favorable premiums is likely to have a beneficial effect so far as premium rates for traditional types of coverage are concerned. To the extent that small companies which are presently "self-insured" would be able to obtain coverage on a collective basis, the result would not be disadvantageous to existing insurance carriers. To the contrary, it would increase their underwriting and, hence, prove beneficial.

We appreciate being given the opportunity to file this Statement in support of S. 1789.

Statement of William J. Dennis, Jr., Director of Research, National Federation of Independent Business

Mr. Chairman, NFIB, on behalf of its 600,000 small and independent business members, appreciates this opportunity to express its views on the proposed Risk Retention Act. The issue of product liability has been of keen interest to large numbers of our members since the mid-70's, and we are greatly pleased with the work of the Inter-Agency Task Force in addressing the situation. Indeed, the recent overwhelming support for this legislation shown by the House is also most gratifying.

The nature of small business

Prior to discussing the specific contents of the legislation being considered, we think it is critical the committee be aware of the general small business climate in order to place our comments in perspective.

Most of the nation's businesses are smaller firms. Even in the manufacturing sector, which is more oriented toward larger firms than any other, 70 percent of the total firms employ fewer than 20 people; 86 percent employ fewer than 50.[1] In other sectors that have a product liability problem, e.g. wholesalers, the skew toward smaller firms is even more pronounced.

While the numbers of small business are large both in terms of total firms and aggregate annual gross, the annual gross of an individual firm is relatively small. For example, of the 43,704 manufacturers employing 5–9 people the average gross was $204,000. (The aggregate gross of all firms in the size classification is $8.9 billion.)

The implications of these data for present purposes are almost self-evident: hundreds of thousands of small businesses need some type of products liability coverage. Because their individual gross is relatively small, the individual firm's ability to absorb even a modest uninsured claim is almost nil. Further, a large deductible for a firm of this size has almost the same effect as being uninsured from the business's perspective. Even though the exposure of an individual firm is generally relatively small, it is just as liable to be a "whopper" as is a firm of any other size. Finally, because the individual firm is small, and because each is enormously diverse not only in terms of products, but also in terms of management capacity and experience, etc., it is difficult for any insurer to spend a proper amount of time evaluating or providing loss prevention assistance to the individual firm.

A second inherent characteristic of smaller firms is difficulty with cash flow. This is particularly true in an inflationary era such as the current one when the cash received for goods at the old price tries to buy materials at the new price. This cash flow problem in conjuction with profits per dollar of sales amounting to between one-half and two-thirds that of large firms,[2] means that a small business is severely pinched to either set aside or directly provide capital for "non-productive" purposes.

It is, therefore, not surprising to find the ability of a small firm to set aside capital for self-insurance, either to cover a deductible or a total product line, severly constrained. In fact, we found that only 2 percent of small manufacturers had such a fund and less than 10 percent indicated such a fund containing modest amounts was readily possible.[3]

While differences occur from industry to industry, it has been established that small firms have greater difficulty passing on cost increases than do larger firms.[4] Any disproportionate fixed cost increases, therefore, can be critical to the small firm. It is constrained to pass along the increase because of market conditions, but it also has difficulty squeezing the profit margin any further.

It has been established that affordability, not availability of products insurance is the critical problem for small business. The foregoing explains to a large degree why affordability (cost) is important to a small firm. Thus, should a firm receive a premium not based on the firm's experience or not based on competitive rates, the individual small firm can face an unfairly critical competitive problem.

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[1] These figures are for the year 1972 and are taken from "Enterprise Statistics," Bureau of the Census.

[2] See "Quarterly Financial Report for Manufacturing, Mining, and Trade Corporations," Federal Trade Commission.

[3] "NFIB Survey Report on Product Liability," January, 1977.

[4] See, for example, "The Impact on Small Business Concerns of Government Regulations that Force Technological Change", Small Business Administration, 1975.

Finally, various studies have demonstrated that small businesses have historically provided the majority of significant inventions and innovations.[5] That has led to increased productivity which has been translated into a higher standard of living for all. Recently, however, we have noted a decline in both the ability of small firms to provide new technology and products, and a decline in American productivity.

The causes of this phenomenon are many and varied, however, the uncertainty and cost surrounding products liability has had an impact. For example, we found that 13 percent of small manufacturers failed to introduct a product due to product liability considerations.[6] While it may have been in the public interest to have some of these products not reach the marketplace, the reverse is probably true for some products as well.

Small business and risk retention

Date for NFIB's January, 1977, Report lead us to suspect that the small business product liability problem involved more than the need for tort reform. Indeed, those suspicions were confirmed by the far more comprehensive undertakings of the House Small Business Subcommittee chaired by Congressman John LaFalce and the Inter-Agency Task Force, both of which deserve strong commendation from small business for their diligent efforts. As a result, NFIB views product liability as a two-sided problem in need of a two-sided solution.

The side this Committee is currently addressing is the insurance problem, so our remarks will be pointed in that direction. We would simply note that NFIB's Department of State and Local Affairs is committed to working with Governors and State legislators to achieve tort reform on the State level.

NFIB supports the Risk Retention Act. The proposal well fits small business's philosophy as expresses in membership votes for increased competition, decreased regulation, no additional government expenditures, no exemptions from anti-trust law, and self-help as means to overcome real problems. In fact, Title II of the bill directly received over 2 to 1 support of the membership (July, 1979).

Title I of the bill is designed to offer or potentially offer businesses (for our purposes, small business) an alternative source of procuring product liability and completed operations insurance. This competition or the threat of competition is expected to bring premiums of individual firms into line with the real risks encountered. Title II of the bill is designed to allow groups of similar businesses to unite for the purposes of purchasing products and completed operations insurance. By spreading the risk over several small firms, rather than confining it to one, premiums should be reduced for all. Both Titles are necessary and mutually reinforcing, although it is our view that different types of small businesses will gravitate to the different opportunities afforded by each.

From NFIB's perspective, the principle advantage of Title I for small business is the threat and incentive it provides the insurance industry to bring premiums into line with actual risk on a firm by firm basis. The reason for this is a simple one. Earlier discussion revealed the typical small business problems of cash flow and limited capacity to pass through fixed cost increases. Title I, however, requires that to establish or participate in a captive all participants must make some type of capital contribution. While each capital contribution is subject to receipt of interest and recapture upon leaving the group, the small firm's capital still remains tied up when it is usually needed badly for other purposes. (It is not clear to us whether the capital contribution must be in proportion to the risk covered.) Thus, a small firm would be inclined not to participate in a risk retention group if similar protection at similar costs can be obtained for conventional sources.

Insurers are aware of this situation as we are. They know their small business customers would not opt for a risk retention group if insurers provided viable competition. But, insurers also know that small businesses have a real option, should Title I be enacted. This provides insurers with every incentive to compete both in terms of immediate premium cost and in terms of loss prevention assistance.

The greatest measure of the success of Title I in a sense would be the lack of use of Title I to establish risk retention groups. If none are needed, then success has been achieved at no more expense than the cost of conducting hearings and printing reports. However, should risk retention groups prove necessary in large numbers, then the propensity of smaller firms to remain with their carriers will have been overcome by a superior product. While the latter situation is obviously not as advantageous to small business as the former, it represents a better condition than currently available. For small business, it is one of those very rare "heads I win, tails you lose" predicaments.

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[5] "Small Firms and Federal R. & D.," U.S. Office of Federal Procurement Policy.

[6] "NFIB Survey Report", op. cit.

In all likelihood, neither idealized model (no risk retention groups or a vast proliferation) will occur. Particularly during periods of tight capacity, we would expect more small businesses gravitating toward such groups with the opposite occuring during a slack capacity. We expect to further find that small firms will principally use risk retention groups to cover their deductives should these continue to be a problem.

As previously emphasized, a small business usually would not want to tie-up its capital. On the other hand, we have also noted that even a loss of deductible could seriously impact the viability of a smaller firm. Given that larger and larger deductibles appear to be required by insurers, risk retention groups created to insure claims under the deductible may become the principle direct manner by which small firms will benefit under Title I.

But again, the small business reaction will depend on the insurer's action. If insurers compete, small business will not want to tie-up capital. If insurers don't compete, they will lose their small business customers to those who will, i.e., risk retention groups.

In our view, Title II is particularly, though certainly not exclusively, apropos for many of the very smallest businesses which frequently do not even carry any products liability insurance. Because of their size, they face all the small business problems previously mentioned only to a greater degree. But we also find that the owner-operator's time is more severely constrained by the demands of his business than would be true in a larger small firm. Additionally he is probably more reliant on his local insurance agent for advice, and it is more difficult for him to leverage a more favorable premium on his products insurance against the remainder of his business coverage. Thus, he is more likely to be "sold" than to be a formulator or any early participant in any Title I group.

Within reason, and depending on the type of product and supposedly the experience history, the greater the coverage, the less premium cost per unit of coverage. That generally means larger firms with identical characteristics to a smaller one receive a more favorable premium. It is, therefore, to the advantage of a group of similar small firms to become one for purposes of purchasing product liability insurance.

Unfortunately, at least 35 states including some of the most populous such as California and New York, now prohibit such a practice. Unaffiliated small firms are prohibited from uniting for purposes of purchasing product liability insurance at favorable rates. By definition these small firms absorb the proportionately higher rates (assuming they choose coverage), placing them at a competitive disadvantage with larger firms exclusively due to an artificial market impediment. Title II eliminates such an artificial market impediment and allows unaffiliated small business to unite for the purchase of product liability insurance, presumably lowering rates for all.

Title II is a natural corollary to Title I. In light of the competition (or potential competition) provided by Title I, insurers will have an incentive to bring together several firms to create Title II groups. Thus, at one time Title II gives insurers a weapon to compete with Title I, and hopefully additional premiums due to a lesser number of firms "going bare," while smaller firms will receive the benefits of a "group" rate.

Conclusion

Small business has a serious product liability problem. Of that there is little doubt. The only question has been how to resolve it in a manner that is fair and equitable to business, consumers, and insurers.

We have all come a long way since the first hearings were conducted in the Senate nearly three years ago. Many solutions have been presented; many solutions have been rejected. All had some serious flaw.

Now it seems we have reached near unanimity on a single piece of legislation, the Risk Retention Act, that appears to have every likelihood of providing equitable relief. The bill is an idea whose time has come. NFIB urges favorable consideration of Risk Retention at the Federal level and tort reform at the State level.

STATEMENT OF THE SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. Chairman and Members of the Committee: This statement is being submitted on behalf of the Small Business Legislative Council (SBLC) an organization of national trade and professional associations whose members are predominantly smaller businesses. The SBLC focuses on issues of common concern to the entire small business community and today represents approximately four million small business firms nationwide. The SBLC has adopted the position, supported by 60 national associations, that manufacturers need immediate relief if they are to survive the current product liability crisis. The self-insurance concepts embodied in the bills, S. 1789 and H.R. 6152 would provide that relief, without foreclosing more substantive reform in the law at the Federal and State levels.

For the past 8 to 10 years, there has been an explosion of manufacturers' and distributors' product liability cases, and the trend now is towards the imposition of liability without fault. The result of the increasing numbers of cases and the large judgments awarded to plaintiffs in these cases has been a corresponding explosive increase in product liability insurance rates. Many manufacturers have experienced increases in their premiums of 1,000 percent and some increases have been much larger. A growing number of companies find that product liability insurance is unavailable at any price, even after 15 or 20 years without a claim against them.

While it is obvious that the increase in product liability and the consequent increase in insurance rates affects businesses of all sizes, small business in general is least able to bear the impact of this development.

The small manufacturer who cannot obtain affordable product liability insurance is faced with two choices—go "naked" (i.e., remain uninsured), or go out of business. In certain cases, he does not have even this choice, as distributors, wholesalers, or other buyers of his product can refuse to handle his goods without proof that he is insured. This may be particularly true if his product is a component of another, and the manufacturer of the finished product is also under product liability pressure. A further example would be the manufacturer of a product, such as a cleaning fluid, who finds retailers will not put the product on the shelf until the manufacturer can show proof of product liability insurance coverage.

The manufacturer who chooses to go "naked", even if he can find people to handle his goods, may have great difficulty obtaining loans or other credit or financing, because of the unlimited contingent liability against his company's assets that going uninsured entails.

Many representatives of the insurance industry have contended that the problems of manufacturers obtaining product liability coverage just do not exist—that coverage is widely available to those seeking it. From the evidence received by the membership of the Small Business Legislative Council's member associations, we find this simply not to be true. Consider, if you will, the following excerpts from letters received by the National Small Business Association (NSB), a national trade association representing 50,000 small business firms.

A New Jersey company writes:

"I would like to take this opportunity to call to your attention a growing problem which has recently affected us * * *. I refer to the growing refusal on the part of insurance carriers to either offer or renew comprehensive liability and products liability insurance. Our company, for example, has paid over $60,000 in premiums over the past five years and during this period of time there have been no claims for which the insurance company has paid out any losses * * *. Notwithstanding this record, we have received word from our former carrier, (company name), that our workmen's compensation insurance, and our comprehensive general liability policies were cancelled * * *. We have diligently attempted to obtain coverage with other carriers, but to date have not been successful * * *."

From a small metalworking company in California:

"Our products are superior in every way, with absolutely no built-in obsolescence. We believe in genuine quality, and our products are virtually hand-crafted. Our small crew machines all the pieces, welds the respective components, and hand-assembles the finished parts * * *. Yet, despite our excellence, we are unable to acquire any "product liability insurance, Even our insurance broker says the quotes are astronomical and ridiculous. Whereas, before the current irrationality, our company could have expected to pay about $1,500 annual premium on $500,000 coverage, now it is more like $7,000 to $10,000 annual premium, on only $100,000 coverage * * *. Of course, going "bare" as we are, like so many other small manufacturers, it definitely narrows and, in some instances, curtails our distribution system. For instance, the large and famous distributors will not handle our products unless we (1) carry sufficient product liability and (2) name them as our vendors. This means that we have already lost Sears Roebuck, J.C. Penney, and Kelly-Moore. This represents a loss to us in prospective sales of untold thousands of dollars worth of business a year * * *. If large distributors of goods refuse to represent us without insurance coverage, then what assurance is there that smaller distributors will not eventually cease to do business with us on the same grounds? * * *."

A large company in the same situation is in much less of a dilemma. Many larger companies have reacted to the soaring rates of liability insurance by buying or establishing "captive" insurance companies (i.e., insurers that are owned or controlled by the larger parent, and can supply insurance, for the parent exclusively). A company with a "captive" insurance company can take advantage of the same tax advantages applicable to any insurance transaction (i.e. deductibility of premium payments), but can also (by virtue of its control over the insurer) control the rates and/or losses of the insurance company. A "captive" insurer which does not write insurance for any outside company would not, of course, be affected by judgments or expenses involved in suits against anyone other than the parent company and is thus somewhat sheltered from the overall increase in product liability costs spread across an entire industry.

Even if a larger company decides to go "naked", it is much more able to cope with the problems this creates. A large company relies less on debt capital than a smaller company, and thus avoids the problems faced by smaller manufacturers who go "naked" and then seek loans. A large company is also better able to absorb the legal costs of product liability suits, and possible judgments, as its cash reserve and other resources are likely to be more extensive. The large company would rarely be forced out of business by product liability claims, even if it is uninsured.

Where insurance is available, but only at a very high cost (often greater than the gross sales of the company), the "smalls" are similarly disadvantaged. Lacking excess cash to meet the higher premium, the smaller company is also less able to pass the cost through to his customers, or to spread the cost over an entire line of products.

With this in mind, we would like to address the inflationary impact of the product liability crisis. When faced with increasingly higher premium costs, smaller manufacturers often must pass this along to their customers in forms of higher prices. In highly-competitive industries, as we have noted, the small company suffers a severe marketplace handicap. In one particular instance recently brought to our attention, a manufacturing company in Oregon added to a farm implements invoice a "Product Liability Insurance Surcharge" of 6 percent of the sales price of the product.

A small company in Michigan, in public hearings before the Michigan House Economic Development Committee, commented extensively on the product liability problems it was experiencing, and how these problems affected sales and day-to-day business operations. Its President has written:

"Product liability has become one of the most serious problems affecting our business. In 1975, our premiums for liability coverage were under $16,000. In 1976 the insurance company who carried us since 1939 informed us they would not renew our policy. After much trouble, we found a company that would insure us at a cost of over $72,000. We had to make short-term borrowings to finance these premiums. This year we were told that the insurance company would not renew our policy at any cost. After searching desperately, we were reinsured by our original carrier at a premium cost estimated to be in excess of $100,000! This is a 625 percent increase in two years * * *. Even though we presently have coverage, serious problems still exist. We are in a highly competitive business and find it almost impossible to pass on this type of cost increase to our customers. Our borrowing capacity is stretched to the limit and dollars that should be going back into the business to improve our plant and equipment and to create new jobs are of necessity being spent in "insurance premiums * * *. Three companies in our industry cannot get insurance at any price even though two of them have never had a single claim filed against them. They are presently "running bare" with the threat of a single suit that could wipe them out along with the loss of all their employees' jobs. I know of many small businesses that are facing similar problems * * *"

The causes of the increase in product liability suits are many. Relatively recent changes in tort law governing the area (making it much easier to pursue a successful suit against the manufacturer and distributor of a product) are largely responsible for the upsurge in product liability litigation, but other factors, such as the increasing cost of medical care and the relatively low level of some State-administered Workers' Compensation awards, have also contributed to the problem.

A solution to the product liability problem lies in statutory or judicial changes in the tort law of product liability, and in providing a competitive market mechanism for handling all or part of a company's product liability risk, if first dollar coverage is unavailable or unaffordable.

One approach highly favored by the membership of the small Business Legislative Council is the pooling concept provided for by the bill under consideration by your Committee.

There are many advantages to small business under the approach advocated by the sponsors of this legislation. Risk-retention groups offer small firms, unable to obtain insurance at an affordable premium, an alternative vehicle for handling all or part of their liability risk. There is flexibility in the proposal, allowing a small business owner to choose the amount of self-retention—insuring for the entire amount, or opting to purchase (where available) regular liability coverage at a higher deductible. In both cases, the small company would enjoy the tax benefits that accrue to purchasers of business liability coverage.

This mechanism is simply not available to our members, as a practical matter. Although it is possible for some association captives to be formed in three States, the regulations in these States and the entry restrictions imposed in other make passage of S. 1789 imperative, if small businesses are to be permitted to take advantage of this important alternative market mechanism.

The small companies whose existence is threatened now by the product liability situation cannot afford to wait years for the picture to change. They need immediate relief. By allowing smaller companies that cannot obtain coverage from insurance companies to protect themselves against the potentially catastrophic results of product liability litigation, the small; business community would receive that relief.

The SBLC urges this Committee's adoption of this unique approach to a grevous problem for small business.

The attached list of 60 SBLC member organizations support in principle the concepts embodied in S. 1789—The Risk Retention Act of 1979.

STATEMENT OF THE NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS

This is a statement of position on S. 1789 (and H.R. 6152), "The Product Liability Risk Retention Act of 1979," by the Professional Insurance Agents (PIA).

PIA is a national association representing more than 33,000 independent property and casualty insurance agents from each of the 50 states, the District of Columbia, Puerto Rico, Canada and the Virgin Islands.

The Professional Insurance Agents is opposed to S. 1789 (and H.R. 6152) because it represents unwarranted federal involvement in the product liability insurance business, circumvents existing state insurance laws and regulations, and ignores existing state mechanisms which provide product manufacturers viable insurance options to the private market. The Act is based on the false premise that states' insurance laws contain barriers to the formation of risk retention groups, which, as a practical matter, preclude their formation. This presumption carelessly ignores the fact that state insurance laws provide a sound framework for the organization and operation of inter-insurance exchanges or "reciprocals," which, like "risk retention groups," are defined as a "mutual organization in which losses and expenses are shared or allocated among the subscribers according to some methods" (D. Reinmuth, "The Regulation of Reciprocal Insurance Exchanges" 11, 1967.)

The Act further disregards the existence of group captive insurance laws such as those existing in the states of Colorado and Tennessee. In testimony before the House Commerce Subcommittee on Consumer Protection in the fall of 1979, the Colorado Insurance Commissioner stated that since the establishment of its captive insurance law in 1973, 29 captives have been formed, of which eight are group captives. He further indicated that an association captive in Colorado where members of the group have places of business or loss exposure. These captives can either use fronting arrangements with existing commercial carriers or provide coverage throughout the U.S. as long as the captives' business is conducted within the state of Colorado.

These many existing alternatives to commercial insurance demonstrate conclusively that the basic underlying premise of the risk retention proposal is unfounded and that the Act itself is totally unwarranted.

The Professional Insurance Agents is further opposed to S. 1789 because it will not accomplish its own goals or objectives. This bill purports to facilitate the formation and sound operation of risk retention groups by eliminating government regulation which might otherwise be necessary for a commercial insurer; however, S. 1789 establishes a network of regulatory authority relative to the creation and continued operation of these so-called risk retention groups which would be vested in the Secretary of the Department of Commerce. Such authority extends, but is not limited to, a review of the group's assets; a determination of the expertise, experience and character of the persons managing the group; determination of the adequacy of loss prevention programs and the soundness of the groups operation. Further, the Secretary may, at any time, perform audits or examinations of a group, which are in addition to the annual requirements for the submission of financial reports.

Curiously, notwithstanding the massive federal regulatory mechanism created by S. 1789, there are no provisions in this bill for either minimum surplus requirements or consumer safeguards against insolvency as provided by state guarantee funds.

A second major purpose of the risk retention proposal is the reduction of insurance costs, particularly for small businesses; but just how S. 1789 would accomplish this objective is unclear. A conservative estimate of the probably costs incurred simply to establish and operate the type of risk retention group envisioned by the Commerce Department could quite easily run in excess of that needed to purchase primary coverage from commercial insurers.

Finally, and perhaps most importantly, PIA is opposed to the passage of S. 1789 because it fails to address the single most significant cause of the existing product liability situation, i.e., the uncertainty in tort liability law. PIA has long maintained that the only long-term solution is reform of the tort litigation system. In this regard, we commend the work of the U.S. Department of Commerce with respect to the development of the Model Uniform Product Liability Act, which is to be enacted by the several states. PIA is in general agreement with the reforms advanced in this bill and is working actively through our 41 affiliated organizations to encourage similar tort liability reforms in each of the states.

In closing, for the reasons cited above, the Professional Insurance Agents strongly urges this Committee to vote against S. 1789, the Product Liability Risk Retention Act of 1979.

STATEMENT OF THE BICYCLE MANUFACTURERS ASSOCIATION OF AMERICA

This testimony is submitted on behalf of the bicycle manufacturer members of the Bicycle Manufacturers Association of America ("BMA"). BMA is a nonprofit trade association which represents four domestic manufactures,[1] who account for approximately 85 percent of all bicycles manufactured in this country, and 12 companies which supply parts to the manufacturers.

We would like to state very clearly at the outset that BMA's member companies recognize their moral, as well as their legal, obligation to do everything they can to ensure that bicycles are designed and manufactured to the highest possible quality levels. Our members also recognize that if a person is injured because one of their bicycles is not properly designed or manufactured, the responsible company should, and will, provide reasonable compensation for those injuries.

The Risk Retention Act is a unique piece of legislation in that it will benefit the business community and consumers alike without in any way restricting or limiting the rights of consumers to seek redress for injuries caused by a defective product. Therefore, the manufacturer members of BMA support passage of S. 1789.

The bicycle industry's product liability insurance premiums increased at a significant rate in the early 1970's. As this trend continued, companies established self-insurance programs, with the company retaining liability in the hundreds of thousands of dollars and purchasing conventional insurance for any liability in excess of this deductible amount. As the cost of the excess coverage increased each year, companies increased their deductible to keep the premium at a reasonable level. Nothwithstanding these increases in the deductible, one bicycle manufacturer's product liability insurance premiums tripled in the five years between 1973 and 1978.

Today, three of the four manufacturer members of BMA self-insure. Two of these handle their own claims, investigation and settlement process. In this way, the companies' believe that they have minimized product liability expenditures; however, even with these measures, the companies' combined expenditure for these administrative costs, settlements and judgments, and insurance premiums far exceed the total amount expended for product liability insurance and claims in the 1970's. The industry is also alarmed by reports that insurance premium rates, including the rates for excess coverage, will again skyrocket the next two or three years. Steps must be taken to avoid these increases in product liability insurance premiums and ensure the availability of insurance. BMA, therefore, strongly supports passage of the Risk Retention Act of 1980.

From the viewpoint of the bicycle industry, this legislation is beneficial in three ways. First, the companies in our industry may join a risk retention group and thereby secure low-cost product liability insurance. Second, if it is not practical for the companies to join a risk retention group, they may join a cooperative buying group and receive a better price on their product liability insurance as a result. Finally, even if the companies in this industry do not join either type of group, we feel that passage of the Risk Retention Act will put pressure on the insurance industry to examine very closely its classification and rate-making processes in an attempt to attain the most accurate and low-cost rate structure possible and thereby minimize the attraction for joining either a risk retention or cooperative buying group.

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[1] The bicycle manufacturer companies of BMA are: (1) AMF Wheel Goods Division, P.O. Box 344, Olney, Ill. 62450; (2) Columbia Manufacturing Co., Inc., 1 Cycle Street, Westfield, Mass. 01085; (3) Huffy Corp., P.O. Box 1204, Dayton, Ohio 45401; (4) Murray Ohio Manfacturing Co., Franklin Rd., Brentwood, Tenn. 37027.

The Risk Retention Act is a deregulatory bill which will increase competition in the insurance market and provide businesses, especially medium and small businesses, with additional options for meeting their product liability insurance needs. The bill will enable companies to minimize their insurance costs without limiting or endangering the rights or remedies of the consumer. Indeed, the consumer will benefit because the price he pays for a product will not, in the future, include the cost of an inflated and unjustified product liability insurance premium.

We believe that the requirements for certification of a risk retention group and the other limitations provided in Title I of the Risk Retention Act are adequate to guarantee the financial integrity of such groups. The fact that it will be in the financial interest of each member to ensure that the group functions properly and efficiently provides further assurances that the risk retention group will be run on a sound financial and managerial basis.

Section 108 of the Act provides that product liability claims data and the other information provided to the Secretary of Commerce pursuant to the Act shall be held in confidence by the Secretary and not subject to judicial process or disclosure under the Freedom of Information Act, 5 U.S.C. sec. 552. Compilation of this type of sensitive information is necessary if the risk retention group and the Secretary are to accurately assess the risks assumed by a group and the adequacy of the group's financing. Companies would, however, be very reluctant to disclose this needed information if plaintiff's counsel were given access to the Secretary's files. It is vital, therefore, that the information compiled pursuant to this Act be immune from legal process and the Freedom of Information Act.

Finally, BMA would like to note that, as presently drafted, this program would be supported by fees collected from risk retention groups and would not require an appropriation from the federal treasury.

BMA believes that the Risk Retention Act is a needed, sound and helpful bill; however, it addresses only a small part of the product liability and insurance problem. While BMA urges its enactment, we would also caution that the bill does not eliminate the need for passage of federal legislation which would allow a company to take a tax deduction for the funds it sets aside in a self-insurance reserve. Such bills complement the Risk Retention Act and would assist those companies which cannot, for a variety of reasons, participate in groups formed under the Risk Retention Act.

Nor does passage of the Risk Retention Act eliminate the pressing need for Congress to enact meaningful tort law reform legislation designed to eliminiate the unfairness and uncertainty that are the hallmarks of our present tort law system.

BMA appreciates this opportunity to comment on the Risk Retention Act.

STATEMENT OF H. M. DICKERSON, SENIOR VICE PRESIDENT, FIREMAN'S FUND INSURANCE CO., SAN FRANCISCO, CALIF.

Previous testimony before the Senate Committee on Commerce, Science and Transportation appears to have been either incomplete or misleading because it has not sufficiently emphasized the availability of liability insurance in general, and products liability insurance in particular, to individual members of a large number of trade associations.

The Fireman's Fund Insurance Companies developed their Commercial Group Division eight years ago. The Division's basic thrust has been to provide all types of property/liability insurance, including products liability, to individual members of various associations. The success of this venture proves not only that coverage is available, but that state regulation does not prevent or inhibit a group approach to this type of coverage.

Through our Commercial Group operation, Fireman's Fund presently insures over 150 such national groups—from warehousing distributors to music dealers. Members of these groups include retail and wholesale insureds and consist of both manufacturing and non-manufacturing businesses. They have diverse insurance needs and exposures, including products liability. These groups range in size from 85 to 17,000 members. Most groups enjoy an interstate membership and the coverage written for them is, therefore, subject to state insurance regulation.

The Fireman's Fund Commercial Group Division, under state regulation, is not only able to provide products liability insurance as well as other coverages to association members, but it is able to do so with services tailored to individual needs. Each insured receives a tailor-made program including:

1. Individual pricing based on the insured's experience, exposure, and needs.
2. Initial premium savings based on administrative efficiencies.
3. Risk analysis and counseling leading to a specific program for those coverages needed.
4. Loss control based on specific needs.
5. Potential dividends.

The dividends referred to in Item 5 relate to specific incentives built into the trade association's safety group, of which an individual insured is a member. These safety groups provide for potential savings based on all lines' loss experience.

Of the 150 groups for whom we currently provide a safety group program, at least 11 are members of a trade association group who supported the Risk Retention Act. Fireman's Fund also provided proposals to other member organizations of this association, but they chose to purchase the needed coverage from other competitive sources.

We have enclosed a sample copy of the type advertisement we have frequently run in the Association Management Magazine,[1] which was also used as one of the formats in the exhibit we ran at their last annual convention. This sample material is indicative of our aggressive posture in seeking to expand our association program business, as well as the type of groups we insure.

While Fireman's Fund is a leader in the commercial group field, we are by no means the only company providing products liability and other essential coverages to members of trade associations. Other companies and several agents' associations emphasize programs for individual members of trade associations. This business is extremely competitive.

In summary, I believe the above will demonstrate to you that, as respects products liability insurance or other property/liability insurance for commercial risks in the United States for insureds who are members of wholesale or retail trade associations, there is no availability problem.

There is no need for the Risk Retention Act, and its enactment will create the problems which have already been expressed in previous testimony before the Committee.

We stand ready to provide any further information requested by the Committee.

STATEMENT OF ROBERT TAFT, JR., ON BEHALF OF SPECIAL COMMITTEE FOR WORKPLACE PRODUCT LIABILITY REFORM

I am Robert Taft, Jr., General Counsel for the Special Committee for Workplace Product Liability Reform. This is a non-profit corporation organized by a group of fourteen trade associations and other concerned parties for the purpose of seeking a remedy to the product liability crisis in the workplace. Our membership includes: American Textile Machinery Association; Bakery Equipment Manufacturers Association; Conveyor Equipment Manufactures Association; Dairy and Food Industries Supply Association, Inc.; Food Processing Machinery and Supplies Association; Foundry Equipment Manufacturers Associations, Inc.; Machinery Dealers National Association; National Machine Tool Builders Association; National Printing Equipment and Supply Association; Packaging Machinery Manufacturers Institute; Pulp and Paper Machinery Manufacturer's Association; Process Equipment Manufacturers' Association; Society of the Plastics Industry, Inc.; Resistance Welder Manufacturers' Association; Black Clawson Company; Dorr-Oliver Incorporated; Fike Metal Products Corporation; The Fitzpatrick Company; Kason Corporation; Littleford Bros., Inc.; Leslie J. Schmidt Associates; and Vulcan Tool Company. Those represented by the Special Committee include a wide spectrum of capital equipment machinery manufacturers, distributors, and marketers including approximately 7,000 companies with a total annual sales volume in excess of $30 billion, employing approximately 2 million employees and operating in all 50 states.

On October 16, 1979, our Committee submitted a Statement to the House Subcommittee on Consumer Protection and Finance to be included in the Record of its hearings on the product liability problem in general. We are attaching a copy of that Statement as Exhibit I and ask that it be included in the Record of your hearings as part of this prepared Testimony. In that Statement we indicated that we have taken the position that the most fair and equitable solution to the product liability dilemma in the workplace is an exclusive remedy for workplace injuries as a part of a Federal minimum standard workers' compensation bill. Through such a "no fault" approach, we can achieve a fair distribution of the burden of workplace injuries. A bill (S. 420) is pending before the Senate Labor and Human Resources

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[1] Copy on file with the Consumer Subcommittee, Senate Committee on Commerce, Science, and Transportation.

Committee which could provide such a remedy. Hearings have been held and we offered testimony in September of 1978.

We recognize, however, that other approaches to the product liability problem may provide substantial or partial relief that would be most welcome. In our Statement, we commented upon four different proposed remedies for the product liability problem. Today I will testify specifically on the substantive aspects of one legislative proposal which is pending before this Committee.

We offer our enthusiastic support of S. 1789, the "Product Liability Risk Retention Act of 1979," co-sponsored by Senators Culver, Inouye, Nelson, Pressler, and Tsongas. Similar legislation, H.R. 6152, was passed this year by the House with the overwhelming margin of 332–17. This legislation offers viable short range relief for what has been termed the availability/affordability insurance problem. I believe that our Statement attached hereto as Exhibit I [1] and the Business Insurance Magazine articles attached hereto as Exhibits II [1] and III [1] thoroughly document the severity of this problem. The costs of product liability insurance have risen so dramatically over the last nine years that many small and medium sized businesses either cannot afford product liability insurance or cannot get it at any price. As we indicated in our Statement, in some cases, insurance premiums have increased 7,000 percent over an eight year period, even for those companies with no loss experience. The Commerce Department found that "while rates did not increase in 1978, individual premiums often did. Moreover, there is some indication that premiums continued to increase in 1979." Deductibles have increased substantially with product sellers being asked to assume an ever-increasing portion of their risk.

The number of companies that are going bare without product liability is a frightening example of the "American roulette" that has resulted from the product liability insurance crisis. Due to this lack of affordability and/or availability and large deductibles, 1978 surveys revealed that 35 percent of the American Textile Machinery Association members and one-fifth of the members of the National Machine Tool Builders Association have gone without product liability insurance at all, each risking bankruptcy should a large judgment be entered against it and providing little incentive for keeping or expanding capital investment in the business. Moreover, this uninsured status provides little certainty of recovery by an injured worker who obtains a judgment. The Risk Retention Act offers a competitive alternative for many businesses which are in such a vulnerable position.

The Department of Commerce has received reports from many observers of the insurance industry who predict a "sharp downswing in industry underwriting profits as early as 1980, which will result in reduced capacity. If history repeats itself, this cyclical downswing could have a severe impact upon product liability insurance costs and availability, compounding the existing problem." In his testimony before the House Subcommittee on Consumer Protection and Finance, James Shamberger, a vice-president of the Reinsurance Association for America, confirmed this when he testified that while he thought the crisis had diminished recently, "the (product liability) crisis will reappear in the '80s."

The results of the work of the Interagency Task Force on Product Liability and the House Small Business Committee establish that one of the major causes of the Product Liability problem in recent years has been the unsubstantiated and subjective rate-making practices of the insurance industry. Haunted by reports of real or fictional product liability cases in which plaintiffs recovered excessive judgments, often based upon tenuous legal grounds, the insurance industry engaged in panic pricing of insurance premiums. Costs of product liability insurance skyrocketed without a factual basis to support such increases. Rates were not related to proven risks or any substantiated projection of future risks.

The Department of Commerce concluded that there were two approaches to resolving this problem. It could propose Federal regulation of insurance companies and their rate-making practices, or it could look to the ingenuity of the American people and encourage a market approach to resolving this problem. Rather than creating a new bureaucracy and adding a new structure of regulatory burden, the Risk Retention Act incorporates regulatory reform and a market approach to solving the product liability problem.

This legislation facilitates the formation and assures the fiscal integrity of product liability risk retention groups. It does this in two ways. Title I of the Act removes the regulatory barriers which currently exist at the state level to the formation of national risk retention groups. It recognizes that the product liability insurance problem is a national problem which requires a national solution, and that the risk retention groups which do not sell insurance to the public at large should not be subject to the expensive and complicated regulation which is appropriate for commercial insurers which do sell to the public. The Department of Commerce would formulate appropriate regulations necessary to assure that the risk retention groups have sufficient assets to meet the risks which are being shared by the members, and that they would be managed in a responsible manner with sufficient reserves and adequate loss prevention programs. As an alternative, Title II of the Act would enable groupings of product sellers to negotiate with commerical insurers for group discounts and benefits. This should be especially beneficial to the very small firms which cannot achieve such cost savings on their own. There would be no Federal regulation of the groups formed to buy commercial insurance on a group basis under Title II.

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[1] On file with the Consumer Subcommittee.

The benefits of the risk retention legislation will be manifold to product sellers, consumers, insurers, and injured parties. By relating insurance costs directly to risk, there should be a substantial reduction in insurance costs for some businesses, particularly small firms which have had good claims experience. Those companies which are currently going bare (because they either cannot afford current product liability insurance or are unable to get it at any cost) would be able to form risk retention groups in order to cover their product liability exposure. Companies with substantial deductibles would be able to fund them and take a tax deduction. The payment of legally valid claims made by injured parties would be assured. The loss prevention program which would be initiated under this legislation would help businesses produce safer products and thereby reduce injuries caused by them. The competition which these risk retention groups would create for the commercial insurers should encourage the commercial insurers to set rates as accurately as practicable, based upon the real risks and the loss experience of the insured. Competition in the marketplace should lower overall costs of product liability insurance and stimulate the creation of innovative and imaginative approaches to insuring product sellers. The insurance industry would have the challenge and the opportunity to service these new risk retention groups as consultants or by selling its insurance or reinsurance to large groups of insureds. Finally, by facilitating the creation of these risk retention groups or cooperatives, we could curtail the current loss of capital and premiums to offshore captive insurance companies.

Some elements in the insurance industry have expressed concern about the Risk Retention Act and have suggested that the risk retention groups would have an unfair competitive advantage over commercial insurers. We disagree. Risk retention groups would be paying the same state insurance premium taxes paid by commercial insurers. The Department of Commerce would subject the risk retention groups to requirements similar to those which commercial insurers must meet at the state level. For example, there are requirements for minimum financial and management standards and proper reserves. Unlike commercial insurers, however, risk retention groups would be subject to the Federal antitrust laws, and they could not make nonpro-rata assessments or retroactive adjustment of premiums paid by their members.

While commercial insurers can offer a broad range of general liability insurance, the risk retention groups would be limited to offering only product liability and completed operations insurance. This legislation would not take business away from commercial insurers who offer an accurate and fair premium rate based on risk and loss experience. Rather, it would offer a facility for those product sellers who cannot obtain adequate first dollar insurance coverage or who cannot afford the insurance at current commercial market prices. Looking into the future, the Risk Retention Act would absorb the impact of the projected downturn in the insurance underwriting cycle by creating new underwriting capacity. We would not be faced with the insurance capacity crisis which we endured in 1973-76. Finally, if the insurance companies reform their own rate-making practices and offer product liability insurance at accurate and fair costs based on risk, there is little likelihood that product sellers will be motivated to form risk retention groups. If insurance is available in the commercial market at prices reasonably close to what the risk retention groups would offer, there would be no need to go through the expense and organizational problems of forming risk retention groups.

This will require a willingness on the part of the insurance industry to reform current rate making practices. The Insurance Services Office Closed Claim Survey data indicated that over 97 percent of product-related accidents occur within six years of the time that the product was purchased and, in the capital goods area, 83.5 percent of all bodily injury accidents occur within ten years of manufacture. "Nevertheless, as the Task Force Report indicated, the underwriters concern about potential losses associated with older products may be an important factor in the recent increase in liability insurance premiums for manufacturers of durable goods."[1] The potential competition of risk retention groups would hopefully induce the insurance industry to take a closer look at its own statistics and adjust its rates accordingly. The insurance industry feels no such inducement today.

Some elements of the insurance industry have also taken the position that there is no need for this legislation because the states have provided mechanisms whereby risk retention groups may be formed. Our members have found such state laws to be useless in fulfilling their risk retention needs. As is stated in the article attached hereto as Exhibit III, "state laws requiring high capitalization rates and imposing other restrictions have sharply limited the use of risk pools." If one of our trade associations wanted to form a risk retention group in Colorado, it must have over $1 million in premiums, it must have been in existence for at least one year, the state must approve its rates, the applicant must show that the insurance coverage was otherwise unaffordable or unavailable, and the actual operating offices of the captives must be located in the state. In addition, the captive could only insure companies operating in Colorado. If it wanted to cover companies in other states, it would have to be licensed to sell insurance in those states. Such restrictions make it difficult if not impracticable for trade associations with members throughout the United States whose products are sold throughout the world to cover their product liability risks through a Colorado captive.

The Risk Retention Act would abolish fictitious group laws currently on the books in 46 jurisdictions which prohibit companies from joining forces to negotiate and purchase product liability insurance on a group basis. Under current state law, group product liability insurance would be unavailable to a multi-state association, so long as one of the states involved has a fictitious group prohibition.

We reject the suggestion by some elements of the insurance industry that these laws can be circumvented by devious and indirect means. I am sure that the members of this Committee would be as offended as we are at such a suggestion. To urge that private companies and associations find methods "to get around" state restrictions is to offer a strong argument in favor of the need for the Risk Retention Act. Small companies that are so desperate to cover their product liability exposure should not be forced to find devious means of getting around state laws. We need the Risk Retention Act in order to offer a straightforward and honest means of insuring against the ever growing product liability exposure of American businesses.

We also reject the insurance industry's suggestion that our members can go offshore to Bermuda or the Grand Cayman Islands to form a captive insurance company. Why should we send American businesses to a foreign country in order to protect against a national American problem? Certainly the current state of our economy does not suggest that we should encourage the movement of American capital overseas.

In reality, the insurance industry is confusing the issue. This Committee is not faced with a choice of whether risk retention groups should be formed at the state or federal level. It is clear that as a practical matter group risk retention is not available to national association members at the state level. The real issue is whether this Committee will facilitate the formation of risk retention groups in the United States through passage of this legislation or relegate our members to the difficult choice of either going to a foreign country for the product liability protection that they must have or going without any protection at all.

A major concern which we have about the implementation of this legislation is whether or not the Internal Revenue Service would treat risk retention groups as insurance companies for tax purposes. It is the intention of this legislation that risk retention groups be allowed the deduction of reserves for unpaid losses, which are not deductible under normal accrual accounting rules or the Internal Revenue Code. Group participants should also be allowed to deduct premiums paid to the group for risk protection as ordinary and necessary business expenses. The five percent limitation on risk distribution set forth in the Act was taken from Revenue Ruling 78-338 in order to maximize the probability that a risk retention group which qualifies for approval under the Act would also qualify for the tax treatment available to insurance companies under the Internal Revenue Code. The uncertaintly of the tax treatment under the current language of the bill may discourage the formation of risk retention groups and act as a disincentive to full use of the Act. I would like to see specific instructions in the Committee Reports, Floor debate, and Conference Reports directing the Internal Revenue Service to interpret our tax laws and regulations in the manner most favorable to encouraging and facilitating the formation of risk retention groups.

I would also encourage legislative language directing that the Department of Commerce formulate such regulations as would be necessary to facilitate the formation of risk retention groups and that such regulations not be overly burdensome or so strict in interpretation of the requirements of the statute as to discourage the fulfillment of its purposes. Similarly, we strongly support that provision in H.R. 5571 which exempts from the Freedom of Information Act all information submitted to the Secretary of Commerce pursuant to the Act. Without this exemption, we cannot expect to get the disclosures of relevant information necessary under the Act. Apprehension on the part of businesses that proprietary information would be made available to the public would discourage participation in risk retention groups.

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[1] 44 Fed. Reg. 62733 (1979).

We commend Professor Victor Schwartz and his staff on the Commerce Department Interagency Task Force for the thorough research and preparation that has gone into the development of the Risk Retention Act. Their outreach to all interests concerned with the product liability problem is evident from the fact that the Risk Retention Act has been endorsed by representatives of business, consumers, and trial lawyers. With such broad support, it should be clear that there is a great need for this legislation. The need is immediate. We urge that this legislation be given priority and that its passage be implemented as soon as possible.

Statement of American Insurance Association

We have received the Senate Committee on Commerce, Science and Transportation staff draft of the Risk Retention Act. Our Association has reviewed the draft carefully. We hope the following comments will prove useful to you. This Association recognizes that the draft constitutes an important effort by the Committee to address the considerable concerns raised by many about the creation of a new federal regulatory authority.

Notwithstanding the fact that the draft has addressed this very important issue, as an Association we remain committed to the concept of insurance regulation buy the states. Such regulation has worked successfully. Insurance regulation ought to remain the province of the states. The Senate staff draft preempts almost all state regulation concerning risk retention group insurers. It is our conviction that this is contrary to the wisdom developed from the successful experience of the states. That experience has produced a competitive industry involving large numbers of insurers. It is an industry where experimentation is common, where ease of entry is relatively simple and where the purchaser can obtain coverage suited to his own needs. Both insurance consumer and injured product liability claimants have been protected.

The AIA, in testimony offered before the U.S. House of Representatives on November 14, 1979 on the Risk Retention Act, discussed its preference for state over federal regulation of insurance. We said:

"To the extent it is alleged that regulatory impediments are inappropriate burdens on the formation of such groups, it was incumbent upon the Department of Commerce to look first to the existing regulatory structure and determine what alternative remedies could be taken. This step was not undertaken. The insurance commissioners in the states have shown a willingness to promote regulatory authority which responds to the needs of insurance consumers, while at the same time protectiong those who must depend upon insurer solvency. This has been done in other lines of liability and could have been accomplished in product liability. What could and should have been done, was for the Department of commerce to have drafted a proposal which identified those regulatory burdens which were inappropriate or overly onerous and directed it to the commissioners so that they might mend these regulations. This could have been done with the use of existing superior expertise on the state level. It would be better than creating a new federal bureaucracy."

Our position in favor of addressing individual state regulations at the state level remains the same. The NAIC in June 1980 adopted a resolution to study this very issue. That resolution reads as follows:

Whereas the U.S. Department of Commerce Task Force on Products Liability and Accident Compensation has testified in Congressional hearings that certain state insurance laws impede the ability of small businesses to insure their products liability risks; and

Whereas the NAIC has expressed concern about the well-being of small businesses but also the protection of consumers adversely affected by products in testimony before the Congress on product liability legislation; and

Whereas the NAIC has pledged in recent congressional testimony to examine "true" impediments to group purchase of products liability insurance by groups of small businesses: Now, therefore, be it

Resolved, That the Advisory Committee to the Products Liability Task Force be directed to identify alternatives for insuring products liability risks of small businesses on a group basis; and be it further

Resolved, That the Advisory Committee to the NAIC Products Liability Task Force review perceived state impediments to these alternatives and report to the Task Force prior to the December 1980 meetings on the validity of such perceptions; and be it finally

Resolved, That the NAIC, through its Task Force on Products Liability, re-examine its position on fictitious group laws and countersignature laws as this position relates to the purchase of products liability insurance.

A federal legislative effort at this time which not only supersedes state regulation but even the states' study of the issue would certainly be premature.

The American Insurance Association has noted that the case for the intervention of the federal government in product liability insurance is unwarranted. Commercially provided insurance is available and is highly competitive. Proponents of the risk retention concept have conceded this fact. They are concerned about speculative events which they claim may lead to market shortages in the future. It doesn't appear that the unusual step of federal action is warranted based upon current market conditions. Testimony in both houses by insurers, agents and regulators showed insurance options and self-insurance mechanisms are readily available.

The staff draft is troublesome because it expands the coverages available to general liability for purchasing groups and to all groups for completed operations. It has never been claimed that there is any shortfall in the general liability market. This seems to be a new addition to the legislation without any justification. The inclusion of all completed operations coverages also goes beyond the problems raised in the debates on risk retention. No one has claimed that completed operations is in any way unavailable to those who are neither product sellers nor manufacturers. We have been told that the draft may intend that risk retention goups would be able to provide comprehensive general liability insurance to their members. This would be a new addition to the Risk Retention Act even as contemplated by the Department of Commerce. The Department suggest that product liability and product related completed operations were the only areas that had been studied with sufficient particularity to require the unusual approach of federal legislation. Product liability is but a part (and not the largest part) of comprehensive general liability. The new inclusion of this liability converts the bill into an intrusion of substantially greater proportions. The justifications offered by proponents of the Risk Retention Act, including affordability, rating practices and availability of insurance, have never been raised with regard to the entire line of comprehensive general liability. These extensions in the legislation legitimately raise our member's concern that legislation intended to address narrow problems tends to expand even if such expansion is unintentional.

The Senate staff draft peempts all state regulation except in the chartering state and three specified exceptions for other jurisdictions (insolvency, premium tax, fair claims). It prevents the states from acting in all other areas no matter how legitimate their concern for their own citizens may be. Such preemption exists where regulation by the state is established on a non-discriminatory basis. The Senate staff bill creates a regulatory override in areas where each of the 51 jurisdictions has already determined there should be a body of regulation. Each jurisdiction's previously established public policy decisions will become subject to the will of the chartering state or foreign jurisdiction.

Under the current configurations of state insurance regulation, groups formed under the Risk Retention Act would not be subject to even the regulations of a chartering state when activities occur outside of that state. This condition will remain the same unless Congress decides to reverse the policy decisions made when Congress decided that the federal government should not be involved in the regulation of insurance. Any decision to reverse that well-established policy is a significant change in the relationship between the federal government and the state governments in the area of insurance as we have known it for the past three decades. If it is the intention to reverse that policy, it will be necessary to draft language with the utmost care. Due to the fact that we have not seen the final language on this proposal, it is extremely difficult to be precise in our commentary. For the moment, the version of the draft we have seen is unrestricted in its preemptive language. There may be an unintentional effect which would prevent the states from enforcing all of their statutory provisions, not just those which relate to the business of insurance.

Even the Department of Commerce recognized the need for continued regulation. The Department of Commerce states in its documents concerning the Risk Retention Act that certain specific impediments existed which it claimed were bars to the free formation of risk retention groups. AIA's testimony before you on April 23, 1980 discussed the Department's position paper in detail. The Department of Commerce did not choose to preempt all other state regulation or create a regulatory vacuum. This severe extension of federal preemption is unrestricted. It overrides countless bona fide legitimate regulations which were not enumerated by the Department as being either inappropriate or particularly burdensome. All state licensing provisions are preempted, as are state registration provisions. Many states, for example, require that an entity doing business in the state register for the purpose of service of process. This legislation and other similar bona fide concerns of the state will be overridden by a federal act solely for the benefit of risk retention groups. The status of risk retention groups will be uniquely preferred in the business community in general and among insurers in particular.

The Department of Commerce, as we noted above, specified some 8 or 9 regulations which they felt were impediments to the formation of risk retention groups. They included among these: capitalization, surplus, deposits, timing requirements, reporting, residual market, rate and policy form regulation, countersignature laws and fictitious group laws. To the extent that the federal override of state regulation and legislation applies only to specially situated beneficiaries, then the federal government is indisputably conferring a competitive advantage. In the absence of a comprehensive review of state regulation and a demonstration that the states ought not to regulate in a particular area, it seems that there is no justification in granting special and unique benefits to risk retention groups.

As the AIA testified in the past, it is clear that if regulations are inappropriate they should be identified and changed. Claimed problems with a few regulations are not sufficient justification to discard the entire system. Insurers are not wedded to irrational regulation—problem areas can be changed. It is possible for the states or the commissioners to specify and change unwanted regulations.

Even within the Department's litany we find included regulations which should not be prohibited to the states. While the insurance industry has found that many reporting requirements are burdensome and counterproductive, it has not disputed the right of the states to collect information in the areas which are subject to their jurisdiction. We do believe that reporting requirements can be simplified and that a good deal of unnecessary reporting can be eliminated. However, many state reporting statutes have been enacted, particularly in the area of product liability, because of legislative concerns with the tort system. The legislators have sought answers to quesitons which are not found elsewhere in insurance reporting in order that they may have information which they feel is necessary to decide what legislative actions they may take with regard to civil liability systems of their jurisdictions. The insurance industry has attempted to point out that such information is unnecessary for such determinations, but we have never attempted to preempt their seeking such information. We do not, on one hand, believe that it is necessary to know how many product liability suits a state may have but, on the other hand, we do not believe legislators and insurance regulators do not have the right to attempt to obtain this information. This is precisely what is contemplated by the present draft.

So long as reporting requirements are imposed in a non-discriminatory manner, there seems little reason why one segment of the insurance industry should be subject to those reporting requirements and another segment should be given the federal exemption. If the federal legislators do agree with the insurance industry that such requirements are burdensome and counterproductive, then it makes no sense for them to provide for an exclusion of such reporting ony to risk retention groups. Yet, on the other hand, if the federal government were to consider preempting the states from any such legislation, then it should be immediately clear that they pierced the boundary of the states' legitimate prerogatives.

The Department of Commerce also noted that the possibility of residual market mechanisms constituted an impediment to risk retention groups. The possibility of the existence on the state level of residual markets in the area of product liability is problematical. No such residual market has yet been established, although authority to create such a market does exist in some states and could be authorized by legislators in other states. The imposition of a residual market requirement on insurers operating in a state is constitutionally confined to related insurance lines. That is to say that health insurers could not be compelled to participate in a product liability residual market nor could a product liability writer be compelled to participate in a health residual market. The non-discriminatory requirement is built into the states' constitutions and legislation. However, if a residual market is brought about and risk retention groups are participating in the product liability market, there seems little reason why they should be excluded from equal participation with other insurers providing the same coverage. If the state has determined that it needs to provide such a coverage through a residual market method, it ought to have the right to tap the consuming public on a basis which would not exclude certain insurers simply because they were operating under the federal law.

The absence of all reporting requirements enforced by the state would seem to make it almost impossible to enforce even the residue of regulation which they are permitted to retain under the revised Risk Retention Act. Without authority to have insurer reporting and registration, states' fair claims practices, insolvency and even premium tax laws cannot apply to risk retention groups without extraordinary additional expense. It may be financially impossible for the states to enforce even their limited residue of authority.

A system of selective state chartering will undoubtedly lead to selection of the state with the lowest of requirements. The use of the state of the lowest common denominator can work to a severe detriment for the insurance consuming public. This is particularly troublesome when the chartering states' insolvency mechanisms may be placed on the line for all the risk retention groups which use it as a haven. The extent to which the chartering states may be able to enforce regulations which occur outside of their jurisdictions is unclear. If entire regulatory burden falls on the chartering state, there may also be a severe economic problem as that state tries to raise sums which would permit it to regulate a new industry of which it may become the focal point. The legislation should permit the chartering state to raise additional sums from those entities which are taking advantage of its facilities.

It has been pointed out that captives are not financially conservative in their operations. They work on the lowest possible capitalization. The fact that they may be backed by state insolvency funds may exacerbate this tendency. They will be aware that in the event of a failure, their members may be indirectly bailed out by the insurance industry. It is also possible that the states unable to regulate may rely on insolvency funds to provide the backup for groups they cannot regulate. This may be a very severe problem if just a few states become the chartering focal point for large numbers of groups.

This particular problem could be solved in a number of ways other than that suggested by the Senate draft. State insolvency funds should not be involved. An insolvency mechanism could be established only for risk retention groups. This could be implemented and coupled with the creation of what the insurance industry terms a stabilization reserve fund. This is the imposition on a risk retention group of a surcharge based upon some percentage of the insurance premiums of the group. That reserve fund builds up until it reaches a certain level at which it is sustained. The fund is then available in the event of insolvency. Another simple approach would be to make the membership of risk retention groups jointly and severally liable for the liabilities of the group. This latter approach would be relatively simple to administer, particularly since the groups would be composed of members of association captives. Florida has almost 15 years of experience with self-insurance for workers' compensation backed by joint and several liability. It has become the largest self-insurance workers' compensation state.

Another area in which the revised Risk Retention Act exceeds even the intentions of the Department of Commerce's original draft appears to be the extension of its benefits to foreign insurers. The states in the past have been successful in accommodating the interests of foreign insurers and the interests of their own citizens. Foreign insurers do operate within the states and have little difficulty in meeting the additional standards which have been imposed by the states on them. There appears to be no reason to grant a foreign insurer benefits granted under the revised version of the Risk Retention Act. We have already speculated that there will be a tendency for risk retention groups to seek the lowest common denominator in the states. Under the staff draft, they not only will seek the lowest common denominator among the states but also among all other countries. There is absolutely nothing which would seem to indicate there is need for this benefit. It has also been suggested by the Department of Commerce that one of the reasons for the Risk Retention Act was to create an attractive market to bring offshore insurance premiums back into the United States. Inclusion of foreign insurers within the provisions of this Act is unnecessary for that business segment and might increase the flow of dollars offshore. It is one thing to tell one of the states that it must bow to the regulatory determinations of another state. It is entirely another matter to compel subservience to the regulatory wishes of foreign nations.

The American Insurance Association recognizes that the Senate has been responsive to comments on the earlier version of the Risk Retention Act. We hope that you will continue to give the new draft the same careful consideration. As noted above, we have fundamental objections to the intervention of the federal government in the area of state insurance. The Department of Commerce identified some specific impediments which they allege prevented the formation of insurance companies which could operate for their members on an interstate basis. As we indicated, this draft goes well beyond the elimination of specific impediments pinpointed by the Department. Rather than discuss it in the body of this statement, I am attaching a list of some other regulations on a statel level which would appear to be jeopardized by the Senate draft.

We recognize that the Senate draft is a new effort to address this area. It is apparent that there will be revisions in the staff draft and we feel they may be of tremendous significance. We would be more than willing to testify and/or to present other evidence if and when additional drafting on this legislation has been completed.

Respectfully submitted.

DENNIS R. CONNOLLY, *Counsel.*

NOTE: A "foreign insurer" is an offshore or alien insurer.

[Telegram]

ALUMINUM COMPANY OF AMERICA,
Cleveland, Ohio, July 15, 1980.

Senator HOWARD W. CANNON,
U.S. Senate,
Washington, D.C.

DEAR SENATOR CANNON: As chairman of the Committee on Commerce, Science, and Transportation we understand you are considering whether or not to take up the Risk Retention Act (S. 1789) which passed the House by a margin of 332-17. This legislation would enable groups of companies to self-insure or buy insurance on a cooperative basis. Virtually every sector of the business community has suffered due to the cost availability of product liability insurance in this country. This legislation would greatly reduce the cost of product liability insurance to those companies able to afford it and make it affordable to those who cannot. We strongly urge you to support this important legislation which involves no revenue loss to the U.S. Treasury and to rapidly take action on this important piece of legislation.

C. R. GILLESPIE,
General Manager, Forging Division.

[Mailgram]

MERCHANDISE MART,
Chicago Ill., July 17, 1980.

Senator HOWARD W. CANNON,
U.S. Senate,
Washington D.C.

The National Association of Floor Covering Distributors is a trade association made up of 400 distributors and 200 suppliers of floor covering products in the United States, and are a member of the National Association of Wholesaler Distributors who represent 115 associations dealing with wholesale distribution.

We have reviewed the staff working draft of the Product Liability Risk Retention Act of 1980 and we strongly endorse the approach taken in the draft. The draft is a very workable and practical solution to our members product liability insurance problems.

We appreciate the work that Senator Cannon and the committee staff have done in developing this new approach, and we strongly urge prompt action to report the bill to the full Senate. It's important to our members and wholesale distributors throughout the country.

Cordially,

WADE D. NEWMAN,
Executive Director.

[Mailgram]

NORTH AMERICAN WHOLESALE LUMBER ASSOCIATION, INC.,
Middletown, Va., July 15, 1980.

Senator HOWARD W. CANNON,
Washington D.C.

North American Wholesale Lumber Association, a wholesale trade organization of 580 firms, is most interested in the product Liability Risk Retention Act of 1980.

We have reviewed the staff working draft of this proposed legislation and feel the approach taken is a good one.

The bill is workable and would relieve our members of current product liability problems.

Senator Cannon and the committee staff are to be complimented on this new approach.

We urge prompt action in reporting this bill to the full Senate.

H. M. Niebling,
Executive Vice Presient.

[Mailgram]

Wine & Spirits Wholesalers of America,
Washington, D.C., July 15, 1980.

Howard W. Cannon,
Chairman, Senate Committee on Commerce, Science, and Transportation,
Washington, D.C.

On behalf of over 800 wine and spirits wholesalers urge endorsement of staff working draft of the Product Liability Risk Retention Act of 1980. The draft bill is a practical solution to severe product liability insurance problems confronting our membership. We commend Senator Cannon and staff for formulating this new approach and urge prompt action in reporting the bill for Senate consideration as soon as possible.

Douglas W. Metz.

[Mailgram]

National Welding Supply Association,
Philadelphia, Pa., July 15, 1980.

Howard Cannon,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Dirksen Senate Building, Washington, D.C.

The National Welding Supply Association consists of 1,050 distributors and 385 manufacturers of welding supplies and equipment with locations throughout the United States.

We strongly endorse the new staff working draft of the Product Liability Risk Retention Act of 1980. We have reviewed the draft and believe it is a most appropriate answer to our members' product liability insurance problems.

We wish to compliment Chairman Cannon and the committee staff for developing this new proposal, and urge prompt action to report the bill to the full Senate.

G. A. Taylor Fernley,
Executive Secretary.

[Mailgram]

National Industrial Distributors Association,
Philadelphia, Pa., July 15, 1980.

Howard Cannon,
Chairman, Commerce, Science, and Transportation Committee,
U.S. Senate, Dirksen Senate Building, Washington, D.C.

Our association consists of 750 distributors of Industrial Supplies and Equipment located throughout the country.

We strongly endorse the new staff working draft of the Product Liability Risk Retention Act of 1980. We have reviewed the draft and believe it is a very suitable solution to our members product liability insurance problem. We want to compliment Chairman Cannon and the committee staff for developing this new proposal, and urge prompt action to report the bill to the full Senate.

Sincerely,

Robert G. Clifton,
Executive Vice President.

[Mailgram]

National Building Material Distributors,
Chicago, Ill., July 16, 1980.

Senator Howard W. Cannon,
Committee on Commerce, Science, and Transportation,
Dirksen Senate Office Building, Washington, D.C.

NBMDA is a national trade association of 410 wholesale distributors of building materials. A large majority of these enterprises are small corporations.

We have watched with interest the development of the Product Liability Risk Retention Act of 1980. In its present form, the bill is an excellent solution to the product liability insurance problems that have confronted our member companies. As an association, we endorse the present staff working draft of this legislation and commend you and your committee staff for producing it.

It is hoped that the bill can now be promptly reported to the full Senate for passage. That passage will be considered a major victory in reducing operating expenses for all of our member companies.

Frank E. O'Dowd,
Executive Vice President.

[Mailgram]

National Association of Service Merchandising,
Chicago, Ill., July 17, 1980.

Senator Howard W. Cannon,
Chairman, Committee on Commerce, Science, and Transportation,
Dirksen Senate Office Building, Washington, D.C.

NASM is a national trade association composed of more than 650 distributors and manufacturers of all types of general merchandise and health and beauty aid products sold through more than 125,000 retailing outlets. We have reviewed the staff working draft of the Product Liability Risk Retention Act of 1980.

We strongly endorse the approach taken therein as it provides a practical solution to a substantial portion of the product liability insurance problem of our members.

NASM compliments you Senator Cannon and your staff for developing this new approach and we urge prompt action in reporting the bill to the full Senate.

J. Spaulding,
Chief Administrative Officer.

[Mailgram]

General Merchandise Distributors,
Colorado Springs, Colo., July 15, 1980.

Senator Howard W. Cannon,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Dirksen Senate Office Building, Washington, D.C.

Congratulations to Senator Cannon and the Senate Commerce Committee Staff for developing a very workable solution to the product liability insurance problems encountered in our industry, GMDC, an association of the general mechandise division of wholesale grocery companies, strongly supports the staff working draft of the Product Liability Risk Retention Act of 1980. The draft bill presents the needed opportunity for industry members impacted by the present products liability insurance rate process to select viable alternatives to obtain relief and should be promptly reported to the full Senate for expedient action.

Richard W. Tilton,
Executive Director.

[Mailgram]

Automotive Service Industry Association,
Washington, D.C., July 15, 1980.

Senator Howard Cannon,
Chairman, Committee on Commerce, Science, and Transportation, Washington, D.C.

Automotive Service Industry Association, the Nation's largest automotive aftermarket association composed of some 8,500 members engaged in all facets of the aftermarket industry, strongly supports and urges favorable action on the staff working draft of the Product Liability Risk Retention Act of 1980. Our review of the draft bill indicates that it is a very workable solution to the product liability insurance problems faced by our members. The new approach developed by Senator Cannon and staff is highly satisfactory and presents an opportunity for immediate relief from the affordability/availability problem now confronting our industry, prompt action to report the bill to the full Senate is urged.

JOHN W. NERLINGER,
Executive Vice President.

[Mailgram]

AMERICAN SUPPLY ASSOCIATION,
Chicago, Ill., July 15, 1980.

Senator HOWARD CANNON,
Chairman, Committee on Commerce, Science, and Transportation, Dirksen Senate Office Building, Washington, D.C.

Representing the nations distributors of plumbing, heating, cooling, piping products, the American Supply Association respectfully submits its endorsement of the Product Liability Risk Retention Act of 1980. Each of the associations 1,200 corporations, in 2,300 locations suffer the burden of escalating the insurance premium cost. The Risk Retention Act of 1980 offers a positive option to ASA members and all others in the business sector. It would add sense and reason to the whole product liability dilemma.

We commend you and your staff for developing this new direction and feel it is of special importance in the face of current economic conditions.

Sincerely,

T. C. GILCHRIST,
Executive Vice President.

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